

LEARNING MADE EASY



Franchise Management

for
dummies[®]
A Wiley Brand



Find a franchise
that fits

—
Raise the capital
you need

—
Ensure your franchise
makes money

Michael H. Seid
Joyce Mazero



Franchise Management

by Michael H. Seid, CFE,
and Joyce Mazero, JD

for
dummies[®]
A Wiley Brand

Franchise Management For Dummies®

Published by: **John Wiley & Sons, Inc.**, 111 River Street, Hoboken, NJ 07030-5774, www.wiley.com

Copyright © 2017 by John Wiley & Sons, Inc., Hoboken, New Jersey

Published simultaneously in Canada

No part of this publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning or otherwise, except as permitted under Sections 107 or 108 of the 1976 United States Copyright Act, without the prior written permission of the Publisher. Requests to the Publisher for permission should be addressed to the Permissions Department, John Wiley & Sons, Inc., 111 River Street, Hoboken, NJ 07030, (201) 748-6011, fax (201) 748-6008, or online at <http://www.wiley.com/go/permissions>.

Trademarks: Wiley, For Dummies, the Dummies Man logo, Dummies.com, Making Everything Easier, and related trade dress are trademarks or registered trademarks of John Wiley & Sons, Inc., and may not be used without written permission. All other trademarks are the property of their respective owners. John Wiley & Sons, Inc., is not associated with any product or vendor mentioned in this book.

LIMIT OF LIABILITY/DISCLAIMER OF WARRANTY: WHILE THE PUBLISHER AND AUTHOR HAVE USED THEIR BEST EFFORTS IN PREPARING THIS BOOK, THEY MAKE NO REPRESENTATIONS OR WARRANTIES WITH RESPECT TO THE ACCURACY OR COMPLETENESS OF THE CONTENTS OF THIS BOOK AND SPECIFICALLY DISCLAIM ANY IMPLIED WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE. NO WARRANTY MAY BE CREATED OR EXTENDED BY SALES REPRESENTATIVES OR WRITTEN SALES MATERIALS. THE ADVICE AND STRATEGIES CONTAINED HEREIN MAY NOT BE SUITABLE FOR YOUR SITUATION. YOU SHOULD CONSULT WITH A PROFESSIONAL WHERE APPROPRIATE. NEITHER THE PUBLISHER NOR THE AUTHOR SHALL BE LIABLE FOR DAMAGES ARISING HEREFROM.

For general information on our other products and services, please contact our Customer Care Department within the U.S. at 877-762-2974, outside the U.S. at 317-572-3993, or fax 317-572-4002. For technical support, please visit <https://hub.wiley.com/community/support/dummies>.

Wiley publishes in a variety of print and electronic formats and by print-on-demand. Some material included with standard print versions of this book may not be included in e-books or in print-on-demand. If this book refers to media such as a CD or DVD that is not included in the version you purchased, you may download this material at <http://booksupport.wiley.com>. For more information about Wiley products, visit www.wiley.com.

Library of Congress Control Number: 2017936488

ISBN 978-1-119-33728-7 (pbk); ISBN 978-1-119-33723-2 (ePub); ISBN 978-1-119-33714-0 (ePDF)

Manufactured in the United States of America

10 9 8 7 6 5 4 3 2 1

Contents at a Glance

Foreword	xv
Introduction	1
Part 1: Wrapping Your Brain Around Franchising	5
CHAPTER 1: The Power of the Brand	7
CHAPTER 2: Franchises Come in Different Sizes	21
CHAPTER 3: Mirror, Mirror, on the Wall	41
CHAPTER 4: The Legal Issues	55
Part 2: Buying a Franchise	79
CHAPTER 5: Researching Franchise Opportunities	81
CHAPTER 6: Raising Capital: Wowing, Wrangling, and Winning	97
Part 3: Operating Like a Well-Oiled Machine	121
CHAPTER 7: Choosing a Location	123
CHAPTER 8: Getting the Goods	139
CHAPTER 9: Training and Hiring	153
CHAPTER 10: Working with Franchisors and Fellow Franchisees	179
CHAPTER 11: Attracting and Keeping Customers	199
Part 4: Expanding or Cashing Out	217
CHAPTER 12: Acquiring Other Franchises	219
CHAPTER 13: When the End Is Nigh	235
Part 5: Building Your Own Franchise	257
CHAPTER 14: From Small Business Owner to Franchisor	259
CHAPTER 15: Recruiting Franchisees	287
CHAPTER 16: Expanding Abroad: International Franchising	319
CHAPTER 17: A World of Good with Social Franchising	349
Part 6: The Part of Tens	373
CHAPTER 18: Ten Keys to Franchisee Success	375
CHAPTER 19: Ten Questions to Ask before Becoming a Franchisor	381
APPENDIX: Glossary of Common Franchising Terms	389
Index	397

Table of Contents

FOREWORD	xv
INTRODUCTION	1
About This Book	1
Foolish Assumptions	2
Icons Used in This Book	3
Beyond the Book	4
Where to Go from Here	4
PART 1: WRAPPING YOUR BRAIN AROUND FRANCHISING	5
CHAPTER 1: The Power of the Brand	7
Tracing the History of Franchising	7
What Is a Franchise, Anyway?	9
The effects of franchising on modern business	9
The success of franchising for business owners	10
What's the Big Deal with Brands?	11
Franchise Siblings: Three Types of Franchising	12
Traditional franchising	12
Business-format franchising	12
Social franchising	14
The Roles and Goals of Franchisors and Franchisees	15
Looking at the world through franchisor lenses	15
The franchisee's end of the bargain	16
Nuances of the Franchisor/Franchisee Relationship	18
CHAPTER 2: Franchises Come in Different Sizes	21
Getting Started with a Single Franchise	22
Where to start: It's two in the morning and you can't sleep	22
Sifting through the options	23
Paying attention to what's hot	25
Adding Franchises, One at a Time	27
Flying solo: Single-unit franchises	27
Growing a family one franchise at a time	28
Developing a Territory on Your Own	29
Becoming a Master Franchisee	32
The Area Rep: Master Franchise Lite	34
Sharing Risks and Rewards in a Joint Venture	35
Councils, Associations, Cooperatives, and Buying Groups	36
Buying Franchisor-Owned Locations	37

CHAPTER 3: Mirror, Mirror, on the Wall	41
Starting Your Own or Joining a Team	42
Consider the Pros and Cons	43
Advantages of making a franchise investment	43
Disadvantages of making a franchise investment	45
Being Realistic about Being a Franchisee	48
Looking in the Mirror: A Self-Evaluation	49
Are you willing and able to learn new skills?	49
Would you rather give or take orders?	50
Can you say goodbye to corporate perks?	51
How is your health?	51
Do you like people?	52
How much can you dish out and take on?	53
Consider your family and friends	53
CHAPTER 4: The Legal Issues	55
Franchise Regulation: A Little History	56
The State Regulatory Landscape	57
The Franchise Disclosure Document	58
What you will find in the FDD	58
The waiting period	59
The FDD, Item by Item	60
Calling out a few key items	71
How much can I make?	73
Additional information available when an FPR is provided	74
Understanding a franchise agreement	75
The franchisor's verbal promises	75
Finding professional advisors	75
Negotiating with a Franchisor	77
PART 2: BUYING A FRANCHISE	79
CHAPTER 5: Researching Franchise Opportunities	81
Digging Up the Good Information	82
The Internet is the place to start	83
Print directories	84
Publications to understand franchising	84
Attending trade shows and expositions	85
Hot and trendy, but does it have any legs?	86
The Role, Risk, and Benefits of Brokers	87
Do brokers work for you or the franchisor?	87
Deciding Whether to Buy Old or New	88
Sizing up an existing franchise	89
Investigating new franchise opportunities	91

	Benchmarking Franchise Offerings	92
	Going Back Home and Eyeing Locations	96
CHAPTER 6:	Raising Capital: Wowing, Wrangling, and Winning	97
	Examining Your Current Finances	98
	Ask yourself some probing questions	98
	Seeing what you can afford	99
	Consider a “used” franchise	99
	Determining Franchise Investment	100
	What your startup costs may look like	101
	Initial expenses to set up shop	102
	Do Your Homework before Holding Out Your Cup	105
	Creating a business plan	105
	The SBA: What they want to see	109
	Projecting income and cash flow	112
	Raising Capital	114
	Avoiding debt	114
	Visiting the bank	115
	Finding an angel investor	116
	Seeking other financing strategies	117
	Social Franchising and Funding	117
	PART 3: OPERATING LIKE A WELL-OILED MACHINE	121
CHAPTER 7:	Choosing a Location	123
	Selecting a Site	124
	Considering common site options	124
	Working a franchise from home	126
	Opting for alternate or off-street sites	127
	Dual branding: Sharing your space	127
	Finding Your Franchise’s Habitat	128
	Finding out what constitutes a good site	129
	Using the franchisor as your compass	130
	Using data to evaluate a site on your own	132
	Protected and Exclusive Areas	132
	Encroachment Policies	134
	Signing the Lease	135
	Meeting Your Franchise’s Requirements	136
	Implementing a franchisor’s designs	136
	Getting approvals, permits, and licenses	137
	Beginning construction	137
	Getting help with the opening	138

CHAPTER 8: Getting the Goods	139
The Basic Requirements	140
Meeting Approved Standards and Specifications	141
Making mandatory purchases	141
The Role of Buying Groups and Purchasing Cooperatives	146
Receiving merchandise	147
Receiving deliveries	147
Checking the goods after they are in your location	148
Verifying invoices	149
Maintaining Inventory	149
Back of the house	149
Front of the house	152
CHAPTER 9: Training and Hiring	153
Getting Good Training for Yourself and Your Management	154
Getting good initial training	154
Receiving effective ongoing training	156
Understanding Joint Employment and Why It Spooks Franchisors	157
Who is the employer anyway?	157
The role of the franchisor in human resources policies	158
Training Your Staff	160
Taking responsibility for getting your gang in gear	161
When English isn't an employee's first language	162
Finding a method to the madness	163
Building and Leading Your Team Effectively	164
Recruiting the right team and rewarding them in the right ways	166
Following equal opportunity guidelines	168
Conducting Interviews	169
Asking the right questions	171
Continuing an interview	173
Doing background checks and other post-interview diligence	173
Retaining Good Employees with a Good Work Environment	174
Fostering a good work environment	175
Hiring good managers	176
Thinning the herd: When terminations need to be done	176
Ensuring workplace safety	177
CHAPTER 10: Working with Franchisors and Fellow Franchisees	179
Playing by the Rules	179
Meeting franchise system standards	180
Supporting and watching the system	182
Attempting to change the system	184

Building a Relationship with Your Franchisor	185
Being a team player	186
Getting what you need from the relationship.	187
Dealing with Change.	191
When the franchise system changes	191
When conflicts occur.	192
Reaching Out to Your Fellow Franchisees	194
Joining advisory councils and associations	195
Being number one in a class of one	197
CHAPTER 11: Attracting and Keeping Customers.	199
Creating an Effective Marketing Plan	200
Evaluating National and Local Advertising Strategies	204
The franchise system ad campaign: Collective marketing dollars at work	204
Local marketing options.	206
All Hail Customer Service	210
Knowing your customers	210
Showing honesty and integrity	212
Making sure customer experiences are positive (and fixing ones that aren't).	213
Looking beyond your cash register.	215
PART 4: EXPANDING OR CASHING OUT.	217
CHAPTER 12: Acquiring Other Franchises.	219
Assessing the Advantages and Disadvantages of Multi-Unit Operation.	220
The advantages	220
The disadvantages.	221
Checking Your Franchise Agreement: Can You Buy Another Franchise?	222
Reviewing Your Resources.	223
Be honest: Are you really ready?.	223
Look at your business and finances	224
Understanding Your Purchase Options	227
Starting from scratch	227
Investing in multiple units	228
Buying a franchise from another franchisee in the system	229
Measuring proximity to yours	230
Retrofranchising: Buying a company-owned location	231
Converting a competitor's location.	231
Acquiring an area	232

CHAPTER 13: When the End Is Nigh	235
Decisions, Decisions	236
Going for Round Two (or Three or Four): The Successor Franchise	238
Paying the successor fee (if there is one)	238
The successor franchise agreement	239
Changes that have sparked controversy	240
Bowing Out at the Right Time	244
Getting personal	244
Examining your world	245
Leaving It to Your Children	246
Selling Out	247
Sprucing up the joint: Getting the most return on your investment	248
Figuring out how much it's worth	250
Playing by the franchisor's rules	251
Selecting a sales method	253
Now That the Party's Over	254
Reflecting on the experience	254
Making the next move	255

PART 5: BUILDING YOUR OWN FRANCHISE..... 257

CHAPTER 14: From Small Business Owner to Franchisor	259
Turning Your Small Business into a Bigger Chain	260
Deciding whether your business should be franchised	261
Putting the preliminary legal requirements in context	261
Criteria for Becoming a Franchisor	262
Do you have an operating business?	265
Will consumers need or want your products and services tomorrow?	265
Are you committed to franchising?	266
Do you have enough potential franchisees and do you know who they are?	268
Do you have a system?	270
Can you teach others how to operate your system?	271
Are your products and services any good?	272
Will the economics of the business support a franchise expansion strategy?	273
Beginning Your Franchise Program: Who Should Take the Reins?	275
Doing it yourself: Success or sure failure?	276
Watching out for "franchise packagers," wolves in pros' clothing	277
Finding professional advisors to guide your way	280

	Passing Go with Your Franchise Idea	282
	Brainstorming a strategic plan	283
	Fleshing out your strategies.	284
	Creating a plan for action.	284
	Developing the legal documents.	285
CHAPTER 15:	Recruiting Franchisees	287
	The Essence of the Ideal Franchisee.	287
	Focusing Your Market Strategy	289
	Reeling In Great Franchisees	291
	Defining the franchisee profile	291
	Doing it yourself or through third-parties	293
	Reaching out through the right media.	294
	Developing the Recruitment Organization	301
	Contact management software.	303
	Finding the right franchise recruiting professional	304
	Staffing your recruitment organization	304
	Ten Steps to Franchise Recruitment.	308
	Steps 1–4: The introductory phase	309
	Step 5: Discovery Day	311
	Step 6: Follow up after Discovery Day	311
	Step 7: Follow up again.	312
	Step 8: Make a decision	312
	Step 9: Close the deal	312
	Step 10: Complete the process	313
	Working the Validation Process.	313
	The Franchise Sales Presentation	315
	Finalizing the Selection Process.	318
CHAPTER 16:	Expanding Abroad: International Franchising	319
	Taking Your Franchise Abroad: Know What You’re Getting Into	320
	Investing capital.	325
	Working with third-party intermediaries.	326
	Budgeting for capital investment	328
	Understanding the necessity of hiring an experienced attorney	331
	Considering the implications of language and culture	334
	Getting your money out	336
	Product sourcing.	337
	Protecting trademarks, trade secrets, and other valuable brand assets.	337

Decisions, Decisions: Whether to Make the Leap	338
If You Decide to Cross the Border	341
Finding the right franchisee	341
Entering a foreign market	342
Negotiating the deal	344
Bringing Foreign Franchises to the United States	346
CHAPTER 17: A World of Good with Social Franchising	349
BOP: The Base of the Pyramid	352
The Challenges for Social Franchising	355
CFWshops: An Example of a Social Franchise System	356
How CFWshops got started	356
Using the hub-and-spoke and other variations of commercial franchising	358
Who Are the Franchisor and Franchisee in a Social Franchise?	360
Financing and Developmental Benchmarks for Social Franchises . .	362
Stage one: Developing and proving the concept	362
Stage two: Proving the replicability of the concept	363
Stage three: Developing the franchise system	364
Stage four: Expanding locally and nationally	365
Stage five: Expanding globally	365
Delivering on the Brand Promise	366
Resources for Social Franchising	367
Government funding agencies for global development	367
Private philanthropic foundations	368
Corporate philanthropists	369
Impact investors	370
PART 6: THE PART OF TENS	373
CHAPTER 18: Ten Keys to Franchisee Success	375
Make Sure You Have Enough Money	375
Follow the System	376
Don't Neglect Your Loved Ones	376
Be Enthusiastic	377
Recruit the Best Talent and Treat Them with Respect	377
Train Your Employees	378
Give Customers Great Service	378
Get Involved with the Community	378
Stay in Touch with Your Franchisor and Fellow Franchisees	379
Pay Attention to the Details	380

CHAPTER 19: Ten Questions to Ask before Becoming a Franchisor.....381

- How Good Is Your Product/Service?.....382
- Can You Manage the System?.....382
- Do You Have the Commitment?.....383
- Can You Systemize Your Business?.....383
- Can You Train Your Franchisees?.....383
- Can You Localize if Needed?.....384
- Do You Have the Necessary Capital?.....384
- Are Enough Franchisees Out There?.....385
- Do You Understand Franchising?.....386
- Are You Willing to Hire Proper Franchise Professionals?.....386

APPENDIX: GLOSSARY OF COMMON FRANCHISING TERMS.....389

INDEX.....397

Foreword

by Robert Cresanti, CFE, President and Chief Executive Officer,

International Franchise Association

In your hands is a powerful book that holds essential keys to running a successful franchise business. It is crucial that prospective business owners and entrepreneurs understand how to properly navigate the franchise business model, and *Franchise Management For Dummies* by Michael Seid, CFE, and Joyce Mazero offers a step-by-step approach to establishing, operating, and expanding your franchise. I've had the privilege of working with Michael directly in his role as an active member of the International Franchise Association Board of Directors. When I first joined IFA, I was repeatedly told to first speak with Michael and read his writings about franchising, including the older title, *Franchising For Dummies*, published a decade ago. His insights served as foundational elements to understanding the business model. To this day, when I need advanced/master crafted counsel on franchise issues, Michael and Joyce are at the top of my "must call" list.

I cannot think of anyone more qualified than Michael and Joyce to write this much-needed book. It contains in-depth information on the history and framework of franchising, including the three types of franchising: traditional, business format, and social. There's instruction on how to research and select the franchise concept that's right for you and what to know when franchising to multiple units. It also includes sections on raising capital, choosing and managing locations, conducting legal due diligence, setting up supply chains, hiring, training, acquiring existing franchises, and mapping out exit strategies. There are even chapters for lovers of top ten lists, covering the ten keys to success and ten questions to ask before investing in a franchise.

Applicable to all levels of franchising from a single-unit franchisee to a large franchisor, *Franchise Management For Dummies* spans the entire life cycle of a franchise business from start to finish.

Franchising is about people and relationships, both inside and outside your organization, which is why the sections on working with fellow franchisors and franchisees is so important. Attracting and keeping customers is another one of my favorites. The lessons in this book go beyond franchising to address how to build

relationships and design processes that are beneficial to everyone in the organization.

This book is essential reading for anyone who is seriously examining the road to small business ownership. Michael and Joyce's deep knowledge of the franchising industry, easy-to-remember terminology, and thought-provoking format makes this the ultimate blueprint for franchising.

According to a January 2017 report from IFA's Franchise Education and Research Foundation and IHS Markit Economics, employment growth in the franchise sector again outpaced the U.S. economy as a whole in 2016, building on a multi-year trend that is expected to continue in 2017. The franchise business model accounts for nearly 8 million jobs at more than 744,000 establishments in the U.S. alone. It offers a path to business ownership at a reduced risk by using existing brands and operational practices.

I'm grateful to Michael and the IFA Board of Directors for their dedication to protecting, enhancing, and promoting franchising. *Franchise Management For Dummies* is an extension of these efforts, as it clearly defines franchising, and in doing so lays out the compelling case why the business model is so important to the U.S. economy and throughout the world.

Introduction

Welcome to *Franchise Management For Dummies!* In our opinion, it's not an overstatement to suggest that because of franchising, our lives have improved immensely. We now have access, on seemingly every street in the world, to an ever-growing expanse of high-quality branded products and services delivered consistently from location to location, regardless of where we shop. Franchising is also responsible for creating significant wealth in the United States and globally through local ownership of businesses supported by franchise systems. Each of those locally owned businesses creates jobs that drive our economic health.

Franchising has also become the most important and largest vehicle for training entrepreneurial skills, while providing the “first rung” on the career ladder for many young people. Just consider the sheer number of people whose first jobs were working at a branded franchised location. In addition, in the past few years the methods and standards found in commercial franchising are being applied to many of the health and economic problems in the developing world. *Social franchising* is a transformational way of delivering products and services to individuals and their families at the base of the economic pyramid (see Chapter 17 for more). Social franchising holds the promise of not just saving countless lives, but of transforming economies that have held people back from achieving a better life for themselves and their communities — not bad for a method intended to create wealth and bring quality products and services to consumers in the industrialized world!

About This Book

Franchising is complex—no one book can provide a complete understanding of its dynamics. That's why we focus on what we believe are the most important elements. In some areas, because they are so complex, we can only go an inch deep and a mile wide. Transforming a complex business approach with so many variations into a friendly consumer book has its challenges and limitations. We highlight those areas we think will provide you with the most benefit. Where we see potential gaps, we remind you to seek professional and experienced help in franchising. In fact, we can do even more than that: Your friendly authors, Michael Seid (mseid@msaworldwide.com) and Joyce Mazero (jmazero@gardere.com), are available when you need us.



TIP

Franchising is a dynamic method of expansion. It will continue to change for many reasons — new methods are constantly being adopted, and technology is changing all the time — but don't worry, even an old dog can learn new tricks. We have created a companion Dummies.com website (more on this later) to keep the information fresh. We will also likely ask other professionals we respect in the world of franchising to contribute to the website, so we strongly recommend — even if you've studied every page of this book — that you check out the companion website.

Most of this book is about franchising as practiced in the United States. After all, modern commercial franchising is a U.S. product, and commercial franchising made its debut in the U.S. under the leadership of one of our founding fathers well before we became an independent nation. (Curious who the first franchisor in North America actually was? Check out Chapter 1.) That said, franchising's importance has grown globally, creating jobs and wealth along the way, because it has the capacity to sustainably and consistently replicate products and services. Its importance is now part of the solution for addressing societal and community needs in emerging markets in Asia, Africa, South America, and elsewhere. Franchising is even being used to effectively deal with the delivery of social services in the industrialized world. Whether you are located in the U.S. or anywhere else in the world, and whether you are in commerce or trying to tackle a societal problem, know that the basics of what makes franchising successful are universal.

Foolish Assumptions

Michael recalls sending out a copy of the original edition of *Franchising For Dummies* — which he and Dave Thomas, founder of Wendy's, co-authored — to the chairman of one of his firm's clients (a brand you know very well). We laughed at the note he sent back which said "Great book, learned a lot, could you send a brown paper cover for it so I can put it on my bookshelf?" All kidding aside, rest assured that you are no dummy for reading this book — in fact, quite the opposite. The *For Dummies* series carefully unwinds complex subjects and transform them into friendly, easy-to-read books.

Our goal for this book is be an essential resource for both novices and experts in franchising. Prospective franchisees can find out what to look for in a great franchisor; existing franchisees can take a peek at what great franchisors are providing their franchisees; emerging and experienced franchisors can gain an understanding about the proper methods of structuring, managing, and expanding their franchise systems; and social impact investors, donors, and NGOs can learn how franchising techniques can transform how they look at providing products and services at the base of the pyramid.

Of course, everyone has *some* understanding of franchising — it's part of our daily lives after all, and most people shop at a franchisee-owned location nearly every day. But many don't stop to realize that they are shopping at a business owned and operated by their neighbor. Franchisors have done such a good job in designing, developing, and managing franchise systems to deliver on a consistent brand promise that many people, including some legislators, believe that franchisees and franchisors do more than share a brand.

Although the sign above the front door may bear the name of a national chain, the name on the lease, on the paychecks, and on the purchase orders is the name of someone local who is risking their capital for the future success of the business. Franchising may be about chain businesses, but *Franchise Management For Dummies* will show you that sharing a common brand and sharing ownership are not the same thing.

Icons Used in This Book

Throughout this book, icons in the margins highlight different types of information that call out for your attention. Here are the icons you'll see along with a brief description of each.



REMEMBER

This points out stuff you should tuck in your brain for future reference.



TECHNICAL
STUFF

If we start digging into a topic beyond the essentials of what you need to know, we warn you with this icon. If you're looking for an in-depth discussion, dig in; otherwise, you can safely skip ahead.



TIP

Tips provide hard-earned insider insights. When you're looking for a better, faster way to do something, pay special attention here.



WARNING

This flags things to watch out for and avoid — proceed with caution.



PLAY THIS

This icon points out more goodies to be found on the companion website.

Beyond the Book

As we've been bragging about, an abundance of information and guidance on franchise structure and management is provided in this book, but not even we could cover every element in the detail required and still fit it all between these covers. That's why we offer a whole lot more help and information online — just go to www.dummies.com/go/franchisemanagementfd. This site is chock full of additional information, including more depth on legal issues, advice on structuring your franchise program, tools to help you select and evaluate franchise opportunities, and much more. Check out the Franchise Management For Dummies Cheat Sheet. Simply go to www.dummies.com and type “Franchise Management Cheat Sheet” in the Search box.

Where to Go from Here

You've embarked on a journey. Congratulations. Neither Michael nor Joyce can be with you in person as you make this journey (unless you give us a call or shoot us an email). We have tried to be your trusted guides throughout this book, and you can consider *Franchise Management For Dummies* to be your roadmap — in a simple, straightforward, and (we hope) entertaining way.

To make the journey, of course, you have to read this book. For the best experience, we suggest simply starting with Chapter 1 and going from there. Certainly if you're new to franchising, starting at the beginning and reading it all the way through would be a good approach. Feel free to flag those sections that you think are the most important to you or that you may not have understood fully. Then go back and read them again — with a broader knowledge of franchising, they may start to make better sense to you.

You can also read each chapter (and even each section) independently, which is useful if you have other things to do at the moment. In each chapter, we note other areas of the book that explore in greater detail some of the information you see.

If you're experienced in franchising, you may want to skip some of the more introductory chapters and focus on the subjects that interest you most or where you need additional guidance. You can use the table of contents or the index to find what you're looking for and flip directly to those sections. And of course, make certain you take advantage of the material on the website.

We hope this book gives you a valuable jumping-off point as you make your franchise decisions. Simply turn the page and begin!

1 Wrapping Your Brain Around Franchising

IN THIS PART . . .

Explore a bit of the surprising history of franchising and get to know the roles of franchisor and franchisee.

Check out the different kinds of franchised businesses and franchising arrangements.

Understanding the similarities and differences between entrepreneurship and franchising to see if franchising is right for you

Dive into a franchisor's mandatory legal obligations to prospective franchisees, the franchise disclosure document (FDD), and working with franchise professionals.

IN THIS CHAPTER

- » Exploring the history of franchising
- » Defining a franchise and the roles of franchisor and franchisee
- » Getting to know franchise wannabes, and why should you avoid them
- » Understanding the rights you will be granted under a franchise agreement

Chapter 1

The Power of the Brand

Three constants have fueled the growth of franchising over its long history: the desire to expand, the limitations on human and financial capital, and the need to overcome distance. Although you may think of franchising mostly in the context of your neighborhood fast food outlets, franchising has transformed how we purchase products and services today. More than 120 distinct industries use franchising today, and because of that it is nearly impossible to drive down any major street in the world and not pass by some business that is part of a franchise network. This chapter begins your exploration of franchising, not by looking at any particular franchise but by giving you some of the basics so you can better understand what franchising is all about.

Tracing the History of Franchising

Franchising seems ageless and omnipresent. It is used commercially today in over 120 industries to deliver to us all types of products and services in a way that allows us to trust in the consistent quality of the franchisor's brand. It is also now being used by social enterprises such as nongovernmental organizations (NGOs) to bring fresh water, healthcare, education, electricity, and countless other products and services internationally to people living in underdeveloped parts of the world.

Franchising is a way for companies to expand and bring their products and services to consumers without the company owning and operating their locations directly. It is a way to create wealth through the establishment of independent local businesses. In addition to creating jobs at those independently owned locations, franchising is the single largest engine of entrepreneurial training in the world and has consistently been one of the driving forces in creating new entry-level jobs in every market in which franchising exists. It is one of the most productive methods ever adopted for the creation of wealth, capital formation, and a solid middle class.

Franchising is not new and it wasn't invented by Ray Kroc or McDonald's. It stems from systems used long ago by governments and by the church. Consider the legends of Robin Hood and Camelot. If you examine the relationships between the kings and the nobles, you can begin to understand the historic impact of franchising. It would have been impossible for the heads of government then to effectively control expansive territories, raise armies, regulate commerce, collect taxes, and provide government services without a structure that provided territory to nobles — who in exchange acted on behalf of the government and shared the local taxes and fees collected. That is, essentially, franchising. Even today, the continuing fee paid by franchisees to franchisors is called a *royalty*. A similar relationship was used by the churches and effectively still is. Franchising allowed for global exploration and commerce, and companies like the Dutch East India Company and the London Company used it to establish trading areas and explore the globe, including North America.

Franchising was first used commercially by European brewers for the distribution of their products to pubs. The first recorded commercial franchise in North America was created by Benjamin Franklin in 1731 in the British colonies, before the United States became a nation. Benjamin Franklin was the Postmaster for the Colonies under the British, and 45 years before the United States became a nation, he and Thomas Whitmarsh entered into the first franchise, or what they called a “Co-partnership,” for the carrying on of the “Business of Printing in Charlestown in South Carolina.” The printing shop published *The South Carolina Gazette* and was the local printer of many of Franklin's writings, including his *Poor Richard's Almanack*. Franklin went on to establish other franchises in the colonies and elsewhere in the years before the Revolution. His third franchisee was Elizabeth Timothé — a woman. At a time when commerce was substantially male dominated, Elizabeth Timothé is recognized as the first female publisher in North America.

Franchising also played a major role as the United States began its territorial and technological growth. Governments granted monopolies to franchisors for the development of railroads, ferries, electricity, roads, and trading posts needed for municipal infrastructure.



PLAY THIS

For more on the history of franchising, check out the companion website (search “Franchise Management” at www.dummies.com).

What Is a Franchise, Anyway?

Franchising is, in a word, a *license*. It is a system for independently owned businesses to share a common brand, distribute products and services, and expand. It's a contractual relationship between a brand owner (the franchisor) and an independent local business owner (the franchisee).

For example, Bright Star Care doesn't "franchise" medical and non-medical home care assistance, FASTSIGNS does not franchise printing, Wetzel's Pretzels does not franchise pretzel shops and Dat Dog does not franchise hotdogs, sausages, and beer. What each "franchises" is a system that delivers quality branded products and services to consumers. And they do so through a network of independently owned and operated businesses that deliver a consistent customer experience.

"Dat Dog is an experience," says Bill DiPaola, president and COO of Dat Dog, based in New Orleans. "It is more than simply the great food and expansive assortment of craft beers that make us successful and that will make our franchisees successful. It is our commitment to community, married with the fun and 'zany' culture of Dat Dog, that brings our customers back and that is the approach we expect our franchisees to take in each of their restaurants."

A franchise occurs when a *franchisor* licenses its trade name and intellectual property — the *brand* and its operating methods (its system of doing business) — to a person or group who agrees to operate their business to the franchise system's brand standards. The franchisor defines the brand promise it wants delivered to consumers, provides the franchisee with initial and continuing support, and then ensures compliance by the franchisee on how it delivers on that brand promise. The magic of franchising is that consistent brand standards can be achieved at each location without the franchisor being involved in the day-to-day management of the franchisee's business.

In exchange, the franchisee pays an initial *franchise fee* to join the system and a continuing fee known as a *royalty* to remain a part of the franchise system.

The effects of franchising on modern business

We have grown accustomed to the consistency that comes from shopping at branded locations. From the comfort of knowing exactly what you will find when you check into a Courtyard by Marriott, to the quality of the chicken at a Popeye's Louisiana Kitchen or a haircut at Sport Clips, people know what they will get when they purchase under a franchisor's brand. The number of companies and

industries bringing goods and services to consumers through franchising is growing, limited only by the imagination of the people who understand its potential application.

The size and impact that franchising has had on the economy in the United States is often unrecognized. According to the Franchise Education and Research Foundation, business-format franchising in 2017 is projected to generate close to 8 million jobs in the U.S., accounting for over \$700 billion in economic output and over \$425 billion in gross domestic product from more than 744,000 establishments. In a recent survey, more than 76 percent of American consumers favorably viewed shopping at a locally owned franchise business in their neighborhood. That's the power of franchising today.

The success of franchising for business owners

Franchising creates opportunities for business ownership to create personal wealth and generates local jobs. It also consistently delivers products and services on a global basis to the brand standards established by the franchisor.

As you explore becoming a franchisee or a franchisor, be wary of statistics that talk about the “success rate” in franchising. As late as 2000, the International Franchise Association published statistics that claimed that franchisees had a success rate of 95 percent — versus a *failure* rate of 85 percent for nonfranchised startups in their first five years in business. Those statistics turned out to be inaccurate and misleading.



WARNING

The IFA has frequently reminded franchisors to not use those out-of-date and misleading statistics, but unfortunately, some franchisors, franchise brokers, and franchise-packaging firms (one-stop shops that offer “cookie-cutter” franchise advice) continue to use them to attract potential franchisees. What should be important is how well a franchise system is doing, and it is irrelevant in choosing any franchise opportunity whether or not franchising in general is doing well. You should be very wary of working with anyone who still uses invalid claims of franchise industry success statistics. In fact, we recommend strongly that you don't work with them at all.

Franchising can be a very effective method of getting into business, but that depends on how carefully the franchise system is structured and supported. Even in highly successful franchise systems, locations *can* fail for a host of reasons. It is up to prospective franchisees to conduct a proper examination of every franchise opportunity that interests them.

What's the Big Deal with Brands?

The *brand* is a franchise system's most valuable asset, because consumers decide what and whether to buy based on what they know, or think they know, about the brand. Unless a consumer has a personal relationship with the local owner of a franchise, they probably don't give any thought to who owns the local business. In their minds, they are shopping at a branch of a chain. This fact is evident in the signs most franchisors require franchisees to post in their locations notifying the public that the location is owned and operated by a local business owner. In the consumer's mind, a company's brand equals its reputation.

"Many brands spend too much time talking about what and how they do things," says Dawn Kane, CEO of Hot Dish Advertising. "Where brands win is when they connect emotionally to the customer. You can't build a solid reputation without that emotional connection. It is the emotional connection that drives consumers into a franchisee's location, and each location's consistency in meeting that brand promise keeps them coming back."

Franchisors focus much of their support effort, time, energy, and money ensuring consistency at each of their locations. This promise of consistency is a major advantage for new franchisees because it is meant to assure them a ready flow of customers. A good brand can communicate a positive message to the customer. Equally so, a bad brand experience can paint a negative message for the entire brand. With a great brand, consumers can visualize and almost feel the experience they will receive even before they enter the local business.

A positive brand recognition is what every franchisee hopes for. With a well-known successful brand, new franchisees don't have to build brand awareness for their business because the franchisor and the other franchisees have already taken care of that. Having a reputation for a positive brand experience is one of the major advantages found in well-established franchise systems.

But brands are not born fully grown. Smaller franchise systems or those with limited brand recognition in markets can't deliver consumer acceptance until the local franchisee creates a reputation for a positive brand experience in their market. This is an issue for new franchisees because they may be required to build brand recognition by spending more on advertising and promotion than where the franchise system's brand is well known. When prospective franchisees review the franchisor's offering, the amount of advertising specified by a franchisor is only the minimum amount they expect will be required — but most certainly is not the maximum amount a new franchisee may need to invest.

Franchise Siblings: Three Types of Franchising

There are three basic types of franchising:

- » Traditional or product-distribution franchising
- » Business-format franchising
- » Social franchising

Traditional franchising

The industries in which you most often find traditional franchising include soft drinks, automobiles and trucks, mobile homes, automobile accessories, and gasoline. The franchisee is typically selling products manufactured by the franchisor. Some examples include Coca-Cola, Ford Motor Company, and John Deere.

Although traditional franchises look a lot like *supplier-dealer relationships*, the difference is in the degree of the relationship. In a traditional franchise, the franchisee may handle the franchisor's products on an exclusive or semi-exclusive basis, while the supplier-dealer may handle several products, even competing ones. For example, Tempur-Pedic mattresses may be offered by a national dealer network that also offers other bedding brands in their retail stores.

The traditional franchisee is closely associated with the franchisor's brand and generally receives more services from its franchisor than a dealer would from its supplier. Frequently the franchisee provides some pre-sale preparation before a product is sold (such as you find with Coca-Cola, where the franchisee manufactures and bottles the soda) or some additional post-sale servicing (such as you find at a Ford dealer with your periodic maintenance programs).

In a traditional product-distribution franchise, the franchisor licenses its trademark and logo to its franchisees, but it typically does not provide franchisees with an entire system for running their businesses. Measured in total sales, traditional franchising is larger than business-format franchising, covered in the next section.

Business-format franchising

The *business-format* franchisee gets a complete system for delivering a franchisor's product or service. The major difference between a traditional franchise and

a business-format franchise is that business-format franchisees operate their business based on a business system largely prescribed by the franchisor. The role of the franchisor is to define the business system and establish the brand standards, whereas the role of the franchisee is to independently manage their business on a day-to-day basis to achieve those brand standards.

McDonald's doesn't franchise hamburgers, and Domino's doesn't franchise pizza. What they provide to their franchisees is a system of delivering their branded products and services. Although traditional franchising is larger than business-format franchising, because the size of the individual transactions is larger, more than 80 percent of all franchise locations in the United States are the business-format type.

It is the franchisee's execution to a franchisor's brand standards that produces consistency — the foundation for a business franchisee's success. Interim Health Care, Sport Clips, PostNet, PuroClean, Twin Peaks, and Firehouse Subs are all examples of business-format franchises. The business-format franchisor provides a detailed system, and the franchisee is trained and supported in their independent management of their business.

The confidential operating and procedures manuals (the how-to guides of every great franchise) provide the franchisee with the information they will need to establish, operate, and manage their businesses. The goal in a franchise system is for customers to get the same brand experience each and every time they shop in one of the franchise's locations, and the manual is one of the tools to achieve that important goal.

“Successful franchises are usually started and operated by people who have been in that particular business for quite some time, and who have developed proprietary techniques for avoiding pitfalls or dealing with them when the unexpected occurs,” says Gordon Logan, CEO and founder of Sport Clips. “Thoroughly documented operating procedures, marketing plans, and training programs are the hallmarks of the most successful franchises. Great franchises never stop improving their systems, always putting the profitability of their franchisees at the top of their priorities while being relentless about maintaining brand standards. Market domination is always a prime objective.”

Although the franchisor provides a comprehensive business system, it is the franchisee's responsibility to manage all the day-to-day affairs of the business. After all, the franchisee is an independent business owner simply operating under a license.

Although franchisors may specify uniforms and other brand standards related to how a franchisee's staff looks (think tattoos, beards, piercing, cleanliness), franchisors don't generally provide any other human resource requirements. Who a

franchisee hires, how much they are paid, what benefits they receive, which hours they work, and how they are promoted and disciplined are all the sole responsibility of the franchisee. Because human resources are the sole and exclusive responsibility of the franchisee and not the franchisor, franchisors and franchisee are generally not considered joint-employers and are not liable for each other's actions or inactions.

Social franchising

Social franchising is the newest form of franchising. *Social franchising* is the application of business-format franchising's techniques and methods to the delivery of products and services to address the needs of people who live at the base of the economic pyramid (BOP). The term *BOP* refers to the estimated three billion people in the world who live on less than \$2.50 per day. Social franchise systems generally focus on the lack of access to basic needs such as safe drinking water, adequate food supply, authentic drugs, quality healthcare, education, sanitation, and energy. These products and services have historically been delivered primarily by governments, churches, and NGOs with mixed results.

According to Julie McBride, senior consultant for social franchising for MSA Worldwide, "Social franchising breaks the cycle of poverty by helping local entrepreneurs develop and expand businesses that solve social needs while at the same time generating profits for the local business owners and creating jobs in the communities they are serving."

NGOs provide a beneficial and important service in bringing critical products and services to the poor. But traditional methods used to provide this type of support are less sustainable than those found in social franchisors. Traditional methods typically lack the level of brand standards found in franchising, and NGOs usually don't typically focus their resources on training and supporting local operators as do social franchisors.

The social franchise model is emerging as a powerful tool for the international development community because of its potential to scale (expand). All the elements found in commercial franchising — including agreements, manuals, training, headquarters and field support, consistent supply chains, brand standards, and enforcement — are also found in a social franchise system.

A significant problem facing both social franchisors and NGOs is the frequent inability of consumers to afford the products and services, and the necessary reliance by the system on donations and other financial contributions. Because most NGOs use a top-down structure (the opening of locations), this often leads to an insufficient focus on ensuring that local product and service providers can sustain the standards found in commercial enterprises like social franchising.

Evolution in social franchise systems is generally driven by the same reasons found in commercial franchising — changes in consumers and competition. In an NGO, changes are frequently caused at the direction of donors and the unique products and services they want the NGO's system to deliver. This, above all else, is one of the reasons that NGOs are not able to achieve the sustainability found in franchising.

The Roles and Goals of Franchisors and Franchisees

The franchisor and franchisee are in distinctly different businesses — they merely share a brand. In a franchise, the franchisor licenses to the franchisee an operating system, and the franchisee provides the products and services to consumers.

As a licensor, the business of a franchisor is to develop, license, support, and expand an indirect system of distribution of its branded products and services. As required under the law, it is the franchisor's responsibility to establish brand standards and enforce how the franchisee meets those brand standards sufficient to protect consumers. In contrast, the business of a franchisee is to independently manage and operate their business to the brand standards established by the franchisor.

In this interdependent relationship, the franchisor generally has no contractual right to manage or supervise the day-to-day business affairs of its franchisees, and its rights to enforce its standards are limited to those agreed to in the contract between the parties. The franchise relationship effectively runs on trust, as the ability of a franchisor to enforce its brand standards is ultimately limited to its right to default and terminate noncompliant franchisees — a relatively high bar under the law.

Looking at the world through franchisor lenses

Who a franchisor is may vary. It can be a large or small company with a long history of successful operations or it can be a startup with little or no experience. Some examples include the following:

- » Roark Capital is a private equity firm with over \$6.5 billion in equity capital. Some of its portfolio companies include 1-800 Radiator, Anytime Fitness, Arby's, Auntie Anne's, Batteries Plus Bulbs, Bosley's, CARSTAR, Carvel,

Cinnabon, CKE Restaurants, Corner Bakery Café, Econo Lube & Tune, Great Expressions Dental Centers, Home Service Stores, Il Fornalo, Jimmy John's, Maaco, Massage Envy, McAlister's Deli, Meineke, Merlin, Miller's Ale House, Moe's Southwest Grill, Naf Naf, Orangetheory Fitness, Pet Supermarket, Pet Valu, Primrose Schools, Pro Oil Change, Schlotzsky's, Take 5 Oil Change, and Waxing the City.

- » Fomami, Dat Dog, Beverly Hills Rejuvenation Center, and Americas Escape Games are small and relatively new to offering franchises.
- » Firehouse Subs, Sport Clips, FASTSIGNS, Bright Star, and 7-Eleven are larger, well-established franchisors.

All great franchisors provide their franchisees with a uniform operating system and train and support them to independently manage and operate their business. When looking at franchising, consider that new businesses don't usually fail because their products or services are of low quality — they fail because of unknowns and lack of resources. Established franchisors have made and survived their mistakes, and that is one of the benefits of working with established companies — you can generally avoid a lot of the minefield of blunders that startup businesses usually face.

Franchisors don't set standards, nor do they provide assistance, out of the kindness of their hearts. It is important to them that their franchisees deliver a consistent, sustainable, and replicable quality of products and services to consumers. They need the system to grow, prosper, make profits, and achieve a solid return on investment at every level, and to achieve that they design their systems so that franchisees can easily execute to their brand standards. If they do that well, franchisees can make money, stay in business, expand, and pay fees. The franchisor's brand value grows as more people shop at its branded units — and because of everyone's success, additional investors will want to become franchisees.

The franchisee's end of the bargain

When you invest in a franchise, you are not buying a franchise. You can't because all the franchisor is providing to you is a license allowing you to use its brand name and methods to operate your business, and you only get those rights for a specified period of time.

As a franchisee, you own the physical assets of your business: the land, building, equipment, and so forth. You are not buying the franchisor's brand or systems, and in some franchise system, the franchisor may even retain the right to purchase your assets when the franchise relationship ends.

It may not sound like much of a deal, but here's what you get when you join a well-established franchise system:

- » Brand standards and enforcement by the franchisor
- » A proven and successful way of doing business
- » A recognized brand name
- » Training and ongoing field and headquarters support
- » Research and development into new products and services
- » Professionally designed local, regional, and national advertising and marketing programs
- » Often, a chance to invest in additional franchises
- » A shortcut around the common mistakes of startup businesses
- » Often, a buying cooperative or negotiated lower costs from suppliers for many of the things you need to run and operate the business (ingredients, advertising, insurance, supplies, and so on)
- » Your fellow franchisees as a network of peer advisors
- » Sometimes a protected market or territory in which to operate your business

Franchisors don't always provide their franchisees with a defined area around their location in which no other company-owned or franchisee-owned business are allowed to operate. Many do, but even then the market area provided may not be an *exclusive territory* and may only be a *protected territory*. An exclusive or protected territory may be defined by the following:

- » The radius or area around the franchisee's location
- » The number of households or businesses in an area
- » The number of people who live in an area
- » Zip codes
- » Counties
- » Metes and bounds using highways, streets, or other geographic measures

Metes and bounds is an old English term still used in real estate today. A *mete* defines the measurement or distance, and the *bound* describes the physical feature like a road or a river. You will see it frequently used to describe territories in franchising.

- » Any other method that defines the area in which no other same-branded location may be established or in which the franchisee has some protection



TECHNICAL
STUFF

From the franchisor’s perspective, if the territory is too large, the total market will not contain enough locations to achieve brand recognition. From the franchisee’s perspective if it is too small or if other locations are too close, there may not be enough customers to support the business.

The goal for franchisors when granting any type of territorial protection is to ensure that they have the right to develop sufficient locations in an area to achieve brand penetration — the number of locations in an area sufficient to service the market and to ensure that consumers see the brand frequently.



WARNING

Even when a franchisee is granted territorial rights, they may not be permanent and may only be provided for a limited period of time. Some franchisors may also require franchisees to reach certain levels of performance to maintain those rights. And in some systems, a protected territory may overlap with another. If you are a prospective franchisee, make sure you read the contract, and consult with a lawyer to make certain you understand the territorial rights the franchise agreement provides.

Nuances of the Franchisor/ Franchisee Relationship

The franchise relationship is contractual, and franchisees and franchisors are not partners. Franchisors don’t have a fiduciary responsibility to their franchisees. That means that the franchisor can do things to benefit itself and other franchisees, even if these things aren’t beneficial to all franchisees.



REMEMBER

In great systems, franchisors and franchisees frequently discuss issues both one-on-one and communally through *franchisee advisory councils* (FACs). But it is essential to understand that it is the sole right of the franchisor to make the brand decisions.

FACs give franchisees a voice in the system’s direction and provide the franchisor with advice in evolving and improving its systems. Often, one of the FAC’s functions is to review ideas for new products and services, whether the ideas come from the franchisor or from a franchisee. FACs are also frequently involved in advertising review and menu or product testing, and help the franchisor to make changes to improve the system.

You may often hear franchisees referred to as entrepreneurs, and franchisees may view themselves as entrepreneurs. But franchisees are not *true* entrepreneurs because if they were they would naturally want to make all the decisions about

how the franchise system should operate and would want to break free from the constraints that franchise systems impose on them. Successful franchisees are “formula entrepreneurs” willing and able to invest in a system and follow the system’s direction. To achieve consistency a franchisor has to make decisions about how the business operates globally. Franchisees may think that they have the next great idea, and often they do, but the franchisor must look at those great (and sometimes not-so-great) ideas and make system-wide decisions.

For franchisees who *are* true entrepreneurs, the restrictions of a franchise system can be overwhelming and may even make the franchisor appear like a dictator. This can lead to disputes and disruptions in the franchise relationship.

If you invest in a franchise, you might not become rich. Not all franchises systems are successful, not all franchisees are profitable, and many franchisors and franchisees fail.

Owning any business is hard and comes with risk. For franchisees, even though you are supposed to get a proven systems and training when you hook up with a solid franchisor, no one guarantees your success. Often, the variable in this equation is you. Business ownership is not a passive investment and it requires long hours and dedication. Even with the best franchise system and the most popular brand name, the franchisee is often the key ingredient to making the business successful.

For emerging franchisors, how they design and develop their franchise system is essential to their ability to grow and support their franchise system successfully. Unfortunately, there is no legal baseline on who can become a franchisor, and how you structure your franchise system is up to you — and no one else.

Have we discouraged you? Scared you? Confused you? Don’t worry. The rest of this book is designed to help you in many ways. Franchising, when done right and entered into with eyes open, can be a profitable, highly enjoyable way to spend your future.

- » Understanding the different kinds of franchised businesses
- » Exploring franchising arrangements

Chapter 2

Franchises Come in Different Sizes

There are a wide variety of franchise opportunities and levels of investment available today. The choice of products and services offered by franchised businesses is limited only by the imagination and skills of the men and women who create them.

More than 120 distinct lines of business use franchising, including hotels, home healthcare, agriculture, car rentals, payroll services, hair care, lawn care, mosquito control, mold detection, restaurants, fitness centers, and everything in between. Because of franchising, national and local brands have leaped into our national consciousness and improved our quality of life.

As you begin to explore franchising, you need to cast a wide net because a number of industries and companies will likely surprise and interest you and the breadth of what is available is wide and deep. Although running a restaurant may be one of the most popular choices available (close to 20 percent of all franchised businesses fall into the restaurant category), restaurants are not the only — or necessarily the best — way to go. You are just getting started. Take your time and explore, and we promise you will not be disappointed by the variety of the opportunities you will find.

Don't dive into the pool too quickly because the selection of possible franchise opportunities can be overwhelming. Wade in slowly, get your feet wet, and choose carefully because becoming a franchisee can be life-changing. This chapter simply introduces you to what is available.

Getting Started with a Single Franchise

Many people naturally begin their exploration of franchising by first looking at the restaurant and food-related franchises because they seem to be on every corner. Without a doubt, food franchises have made many franchisees happy and wealthy (they were probably already wise, so franchising cannot take credit for that). But don't be too surprised when we tell you that many non-restaurant opportunities not only do better financially than some of the better-known restaurant concepts, but they also may offer a more stable investment and might even be easier to operate.

Where to start: It's two in the morning and you can't sleep

We have all been there. The career we trained for in school and the job we thought was the one we would have until we retired are under challenge because of the economy and/or technology. Maybe your company is moving out of state, or you're simply bored and it's just time to change direction. Beginning to work for yourself and achieve what some call, the Great American Dream of independent business ownership might be something to consider.

Going it alone and opening your own business from scratch are very good options. Many people do, and it can be highly successful. If you are a true entrepreneur, it may be your best choice. But if going it "alone" includes being part of a branded system, franchising is a path to consider.

A good place to begin exploring franchising is on the Internet, and the good news is that at 2 a.m., it's open. At this stage of your investigation all you want to do is begin to narrow your search to industries and companies that are attractive to you.

Every franchise opportunity has a website touting why it's the perfect investment opportunity. Each will have multiple competitors including many you have never heard of. You are also going to find industries using franchising today that you didn't know even existed. To begin to understand the breadth of the

opportunities, you need a guide. Thankfully, there are numerous compendiums of franchise opportunities, and the best ones are online.

We admit that we are partial to the online Franchise Opportunities Guide published by the International Franchise Association (IFA) at www.franchise.org/franchise-opportunities. It may seem disloyal if we were not, since both of your authors have held leadership positions in the IFA for quite some time. But there are also other outstanding web portals you should consider, including the following three:

- » Franchising.com published by Franchise Update Media (www.franchising.com)
- » Franchise Times (www.franchise.org/franchise-opportunities)
- » *Entrepreneur* magazine (www.entrepreneur.com/franchise500)

Both Franchise Update Media and Franchise Times are franchising giants that are read and relied upon by the professionals in franchising. As with the IFA, each publication also contains resources including articles written by professionals, educational tools, conference information, and contact information for professionals in franchising. *Entrepreneur* includes a ranking of the franchise opportunities they list.



WARNING

We may take some heat for saying this, but based on our experience we recommend that you never choose a franchise system to invest in because of any third-party ranking. Chapter 4 explains why.

Sifting through the options

As we mentioned, over 120 industries use franchising, but to make your review a bit easier, here are the broad lines of business categories:

- » Automotive
- » Business services
- » Commercial and residential services
- » Lodging
- » Personal services
- » Quick service restaurants
- » Real estate

- » Retail food
- » Retail products and services
- » Table/full-service restaurants

As you begin your exploration you will find within each line of business a long list of franchise opportunities in a variety of industries. Unfortunately, there is no universally adopted classification system in franchising, and each source guide will use different industry and business classifications. That can make things confusing, because you may think that companies within a given category are similar, but that's not always true.

For example, take something as simple as pizza. Some pizza franchisors provide a system in which pizza is delivered to customers' houses, whereas others don't provide home delivery. Some may only have eat-in facilities, others offer both eat-in and home delivery, and for others, the customer must pick up the pie. Some have pies priced for feeding a little league team, and others are gourmet offerings. There are companies like Papa Murphy's where you can customize your pie at the store and then take it home and bake it yourself at 425 degrees. (Your family might even think you know how to cook if you hide the box from them). All these businesses are pizza franchises and may show up in some source guides under the same category. But their varying features make them significantly different types of franchise and investment opportunities.

The investment required will also vary widely, as will the types and number of employees you will need, types of real estate you can use, equipment requirements, amount of money you can earn, the markets they have available for you to invest in, and maybe even the number of locations the franchisor will allow you to open. In some systems you may only be able to open in mature markets, and in others you may have the opportunity to build the brand in new markets, which opens up for you some interesting possibilities.

Let's move on to hair salons. Some franchised salon chains are geared to cutting only men's hair while others focus on women. Some are full service and provide waxing, coloring, manicures, and perms, while others are limited service opportunities like Great Clips targeting their customers based on their low price for a haircut and how quickly you can get in and out. There are even those that specialize in haircuts for children, and concepts like Sport Clips that are based on a sports theme with TV screens tuned to sporting events. All hair salons may work on hair, but how they segment the market and approach their customers differ widely from company to company.

"Great Clips has as its core service, haircuts, and our price for services has barely changed over 35 years," says Steve Hockett, president of Great Clips, Inc. "Our

goal has always been to provide a great experience for customers with short waits, moderate pricing, convenient locations and hours — for men, women, seniors and kids. We have never wanted to be all things to all people, which is why, for example, we have never provided coloring services. We have a simple business, with a consistent focus, and it has served Great Clips franchisees well, with over 4,100 salons open in 175 TV markets across the U.S. and Canada.”

In a similar fashion, franchises within the fitness and gym industry range from traditional gyms to specialty fitness centers with a focus on a specific type of workout (such as Pilates, Zumba, barre, cycling, or boxing) and some are open 24 hours a day. There are concepts that offer memberships only to women and there are still others that offer ancillary services, such as nutrition consulting, massage, or tanning services.

There is so much information about franchise opportunities available today that you can easily get overwhelmed. The vast investment differences between franchise opportunities listed under the same broad industry heading is one of the reasons why we recommend you ignore the ratings given by some of the publications. Two companies may both sell pizza, but from an investor point of view, they are in very different industries.



TIP

The easiest way to conduct your research is to select one great source of information that is clearly written, understandable, and available in a style you understand (sort of like this book). Put the other sources aside and do all your research using that one guide. Only after you get your list of possible industries and companies down to a reasonable few should you also explore those opportunities by name in the other listings. Working this way is much easier, and usually you will not miss much of the information that you will need at this early stage of your investigation. Using the IFA, Franchise Update, Franchise Times or *Entrepreneur* listings are good ways to begin.

Paying attention to what’s hot

So which franchises are hot?

That is always the first question asked of us by reporters and every prospective franchisee we meet. We will give you the same answer we give to them: *It depends*. With all the industries that use franchising and all of the companies offering opportunities in those industries, it is hard to give a meaningful answer. What is hot this year may not be next year. And most importantly, what we may consider hot may not be something that fits what you are looking for. Becoming a franchisee and choosing the right opportunity is a very personal decision — one that you must ultimately make yourself.

Start by looking for the trends and see who is capitalizing on them:

- » If health and wellness is what attracts you, and fresher, locally grown, upscale, and grown-up food are what you're looking for, then maybe one of the brands populating the fast casual segment, like Blaze Pizza, may be the right choice for you. If food is not something that excites you, then possibly a fitness concept like Kaia Fit or a nutraceutical concept is where you should look.
- » If you think that having Mom and Dad working longer hours outside of the home has created an opportunity for helping families save time and parents better bond with and care for their children or parents, take a look at franchise systems that provide children's education and entertainment or home healthcare like the Goddard School, School of Rock, or Bright Star.
- » Paul McCartney wrote "When I'm 64" when he was 24, and in 2006, when he reached that magic number, he was glad to learn that today's 64 is yesterday's 44. Servicing the senior citizen who is living longer and healthier may be your magic ticket as demographic and sociographic trends support those industries' growth. Fitness concepts like Blink or Orangetheory or maybe a golf business like GolfTEC may be attractive to you.

Every year, new trends even in legacy industries unfold. Consider that quick service and fast casual restaurants are going through rapid changes to their labor models as apps replace waitstaff and robots begin to replace back-of-house staff. Similarly, hotels are lowering their operating costs by using online reservation systems, even providing guests with room keys before they arrive. Many are changing their décor and services to attract millennial travelers, like Marriott's Moxy or Hilton's Tru.

Because of changes in demographics, consumer trends, technology, the economy, and geopolitical events, existing franchises will change, and exciting new opportunities will continue to emerge. Follow the trends, look through the fads, and somewhere on the other side you will find a company that has started a franchise system designed to capitalize on the opportunity interesting to you or an older brand like Popeye's Louisiana Kitchen remaking itself for the same reasons.



TIP

If you choose to invest in a franchise in one of the popular industries, you might consider a newer or smaller franchise system. Emerging franchisors are often more flexible with respect to development, training, and fee structures than the larger, more established ones. Alternatively, you may want to go down the less-worn path and look closely at opportunities in less-popular industries that you believe, based on your research, are just now starting to become popular.



WARNING

Keep in mind, though, that the smaller systems, while possibly more flexible in working with you, may not offer all the benefits and services of the larger, better-established franchisors. A strong legacy system — one that can provide you with the operational support and efficient supply chain you need — can be a very attractive investment. Although you may need to invest more in marketing your location, becoming established in a new market can have some terrific benefits as well.

Adding Franchises, One at a Time

The number of franchisors, the variety of industries represented in franchising, and the range of investments available create opportunities for the smallest single-unit mom-and-pop operator to a large multimillion-dollar investor group or established businesses that are looking to add a franchise investment to its portfolio.

Flying solo: Single-unit franchises

A *single-unit* or *direct-unit franchise* is just what it says it is: As a franchisee, you obtain the right to own and operate one franchised business from a franchisor.

Over the years, most franchise systems have grown one franchise at a time. It is the classic method and, until the past few decades, was the most common type of relationship in franchising. As people looked for a way to get to their dream of independence through business ownership, franchising became their chosen vehicle. In a single-unit franchise, the franchisee (often along with family members) generally manages and supervises the business on a day-to-day basis. It is how their family makes a living.

Although a single-unit franchise is the classic method for franchise system growth, it does have some weaknesses for franchisors:

- » Franchisors generally experience slower growth with a single-unit strategy than with a multi-unit approach, and the growth can be more costly on a unit basis because franchisors have to locate a new franchisee for each location.
- » The franchisor has many franchisees to work with, and those franchisees may be less sophisticated and less interested in taking business risks than larger, multi-unit franchisees.

- » Because each location is individually owned and operated, single-unit franchises tend to be more expensive to support than when one franchisee owns and operates multiple locations.
- » In some markets that may be attractive to a multi-unit franchisee, the presence of single-unit franchisees in the market may make the opportunity less attractive to multi-unit operators who don't want to compete for customers or locations.

Although there may be some disadvantages to franchisors, there are more single-unit franchisees looking for opportunities than there are multi-unit investors. Also, because the locations are managed directly by the franchisee and generally are a significant part of the franchisee's family income, single-unit operators tend to be better focused on operating their locations to brand standards and contributing to the neighborhoods in which their businesses are located. That's because they usually live in the community, their children go to the same schools, they attend the same churches, and their customers are their neighbors.

Figure 2-1 displays the single-unit franchise relationship tree.

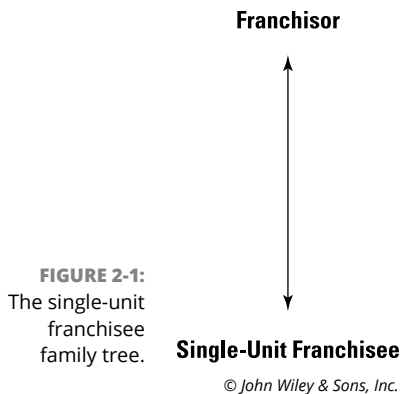


FIGURE 2-1:
The single-unit franchisee family tree.

Growing a family one franchise at a time

As single-unit franchisees prosper (see the preceding section), eventually they will want to acquire another franchise from the same franchisor. After all, they have an understanding of the business, have a relationship with the franchisor, can project the return that an additional unit can generate, and know the types of locations that work best. Initial training likely won't be needed, and some of the key employees they already have may be perfect managers in their second and third locations.

As they add additional locations, their little chain now can leverage off of the prior locations by sharing staff, inventory, storage, and back-of-house resources like bookkeeping and payroll processing. Investing in additional franchises is a terrific way to grow, because with experience their risk is generally lower than when they made their initial franchise decision, and even though they have more franchises, the relationship between the franchisor and franchisee is substantially the same.

However, growing one location at a time is different from agreeing to operate multiple locations from the beginning, because you don't usually obtain a reduction in initial or continuing fees and you'll continue to share the market with other franchisees. But with more units and more money invested, you will tend to be noticed more often by the franchisor and its staff because they are hoping you will continue to grow and grow and grow.

It's important to understand that franchisors will periodically update their franchise agreements, and franchisees who acquire additional franchises are likely to find variations between their original contract with the franchisor and the new franchise agreement for later units. Your franchisor may also include *cross defaults* in the agreements, meaning that if you can be terminated at one location, the franchisor reserves the right to terminate all of your franchises at the same time — even if every other location is operating perfectly.



WARNING

As with all franchise agreements, you should have a qualified franchise attorney work with you. They may be able to also help you negotiate some changes to your agreements including personal guarantees, cross defaults, and changes in fees that other franchisees may be required to pay.

Developing a Territory on Your Own

Instead of growing one location at a time, many franchisees instead choose to become multi-unit franchisees right from the start. By entering into a *multi-unit development agreement*, a developer obtains the right and the obligation to open a specific number of locations during a defined period of time and usually within a specified contiguous geographic area.

For example, say you want to open ten hair salons in your town. You can go to the franchisor and buy one franchise at a time (see the preceding section), but you have certain risks:

- » You may have to share the market with other franchisees from the system. And by the time you're ready to grow, the best locations for your brand may have been taken by other franchisees, or worse, the franchisor may have

achieved critical mass in your market and is no longer offering additional opportunities where you want to grow.

- » Even if the franchisor is offering a better “deal” to multi-unit developers, it may not be offering that same deal to single-unit franchisees, and you likely won’t have the necessary leverage you need to negotiate the changes you want.

To avoid these risks, you can enter into a multi-unit development agreement and agree to open and operate your multiple locations, say over the next several years, and the franchisor will grant you an exclusive market to develop your little chain.



TIP

If possible, you want your multi-unit development agreement to include *market exclusivity*, ensuring that you are the only franchisee operating in your area. Frequently, though, there may already be locations up and running in the area you want, and you’ll need to decide whether market exclusivity is important to you prior to making your investment decision.

A multi-unit developer will typically pay the franchisor a fee for the right to enter into a multi-unit development agreement. As you sign a franchise agreement for each new location, generally a portion of the multi-unit development fee is credited by the franchisor against your initial franchise fee. (More on this shortly.)

Expect that your development obligations will be specific. For example, instead of simply agreeing to ten units over five years, your agreement will usually have precise dates that you must meet, such as requiring that you have your locations open and operating on January 1, July 1, and so on during the term. These opening dates are important to the franchisor, so if you think the time provided for development is too restrictive or ambitious, this is something you and your attorney should discuss with the franchisor before you sign the development agreement.



WARNING

Don’t expect the franchisor to allow you to slip on your opening dates later on — missing those dates might trigger certain terminations and cross default rights by the franchisor, including the loss of your development rights and the fee you have paid.

Frequently, the initial franchise fee for locations developed after the initial franchise in a development agreement will be reduced from the franchisor’s standard initial fee. However, how the franchisor applies your development fee to the initial franchise fees you will owe varies from company to company.

In most franchise systems, as the franchisee signs a new single-unit franchise agreement and pays the initial fee, a pro-rata portion of the development fee paid will be applied to the initial franchise fee due. In other situations, you will receive no credit and you may pay the full initial franchise fee for each location.

You can expect that the development agreement may modify some portions of your franchise agreements. In addition to changing the initial franchise fees you may be charged, the franchisor may offer a reduced royalty after a certain number of locations have been developed, and changes in training, site selection, and development are common. You can also expect your franchisor to require you to have a general manager overseeing your units, and they may require you to have someone on staff to conduct the training of your staff.

A multi-unit development relationship can have significant advantages for both the franchisor and the multi-unit franchisee.

For the franchisor:

- » Each multi-unit franchisee will be opening more than one location. That means the cost of acquiring a franchise on a per-unit basis will be lower than had the franchisor needed to find separate franchisees for each location.
- » Fewer franchisees owning multiple locations means that the cost of supporting each location may be lower because the franchisor will be working with the franchisee's general manager for all the locations and may not work with separate unit managers for each location.
- » Having controlled growth leads to better planning for advertising and better leveraging when negotiating with suppliers and other vendors.
- » With fewer franchisees in a market, it is easier to coordinate local advertising and promotions.

For the multi-unit developer:

- » You gain the ability to shift personnel from one location to another depending on where the staff is needed.
- » You may be able to establish a commissary or kitchen and combine the preparation of products for all the locations or save on freight and other costs by buying in greater quantities at a lower cost and storing inventory in a centralized warehouse, allowing for smaller retail locations and lower real estate costs.
- » General managers overseeing multiple locations may reduce management costs at each location. Franchisees may only need an assistant manager, and with consolidated back-of-house support staff, including a trainer, internal costs on a unit basis can be reduced.

Figure 2-2 depicts the multi-unit franchisee-franchisor relationship.

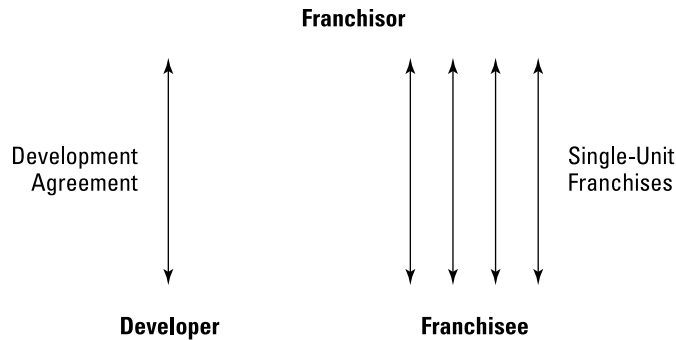


FIGURE 2-2:
The multi-unit
franchisee
family tree.

© John Wiley & Sons, Inc.

Why are two agreements needed? Because the multi-unit development agreement and the franchise agreement serve different purposes. The multi-unit development agreement lays out the rights and obligations being granted to open the locations, and the franchise agreement governs how each location, as part of the franchise system, will operate.



REMEMBER

Make certain that the market you select can handle the number of locations you've committed to open, that you have the financial backing to live up to your development obligations, if the first location gets off to a slower start than anticipated, and most certainly, that you are ready and able to operate each location per the terms of the individual franchise agreement.

Becoming a Master Franchisee

When you become a *master franchisee*, you become a franchisor in an area and are authorized to offer subfranchises through your master franchise license. As with any franchisor, your master franchisor will prepare and provide to prospective franchisees its own FDD and agreements that will contain information about you and your services.

In most master franchise relationships, the first thing you will likely be required to do is open and operate a few locations of your own. Once that has been accomplished, you will then be allowed to offer franchise rights to other franchisees (called *subfranchises*) to open and operate franchises in your market.

You will sign a master franchise agreement with the franchisor and usually pay a *master franchise fee*. Because your subfranchisees pay you their initial franchise fees and continuing royalty, typically you share a portion with your franchisor. The percentage split will vary widely depending on the franchise system. There is no standard master franchise relationship:

- »» The subfranchisee may execute a franchise agreement directly with the franchisor or with the master franchisee.
- »» The franchisor may or may not have the right to approve the new subfranchisee.
- »» The subfranchisee may receive training and continuing support from the franchisor, the master franchisee, or both.
- »» The subfranchisee may pay fees directly to the master franchisee, to the franchisor, or a combination of both.

Of all the types of franchising relationships, the master franchise or subfranchise relationship is the most complex.

Figure 2-3 shows the master franchise relationship.

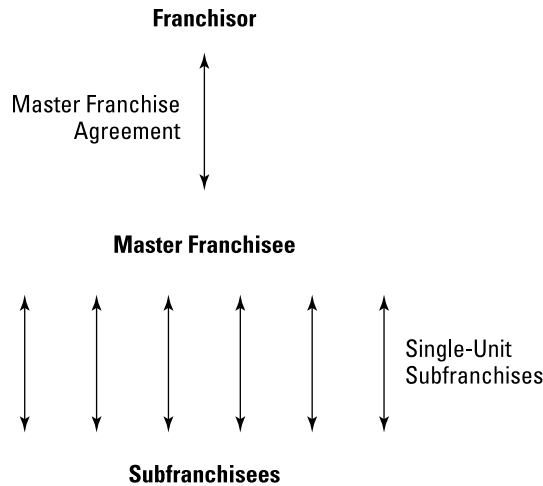


FIGURE 2-3:
The master franchisee family tree.

© John Wiley & Sons

With the exception of foreign franchisors entering into the United States, don't expect a lot of U.S.-based franchisors to offer a master franchise relationship today. Although it is still used to some extent by U.S. franchisors internationally — and the trend is shifting away from master franchising to multi-unit development relationships, as technology and other advancements have made it possible to better directly support franchisees internationally — its popularity is waning.

If you are a franchisor looking at developing internationally, and that includes foreign franchisors entering the United States, we recommend that you first consider going direct and offering a multi-unit development agreement and not use

a master franchise relationship. By franchising directly to multi-unit franchisees, you avoid the need to share the fees and other revenue in a market and retain most of the benefits of master franchising. Technology has reduced the need for master franchising to a very great extent, and with a well-structured multi-unit development growth strategy, much of the expected benefits of master franchising are no longer as significant.

There are occasions where master franchising still makes sense, and in those circumstances both of your authors still use it with our clients. But rarely today is it our first choice, and we generally explore other approaches first.

The Area Rep: Master Franchise Lite

Both an area representative and a master franchisee acquire a territory in which to solicit and support franchisees, and both share in the initial and continuing fees collected from franchisees with the franchisor. The difference is that the area representative is not a franchisor, does not deliver their own FDD, and doesn't execute any agreements with the franchisees. In essence, an area rep is a commissioned sales and field support person for the franchisor.

As in a master franchise relationship, the area representative pays the franchisor a market development fee for the opportunity to develop and provide services to a specific minimum number of units, during a specified time period in a defined area. Once recruited, the franchisees sign their single-unit and multi-unit development agreements with their franchisor.

For many of the same reasons discussed earlier related to master franchising, the use of area representatives is on the decline. An area rep can recruit franchisees quickly. But because they share in the franchisor's fees, rather than earn their income as an employee, there is a strong argument that they tend to depress the exit or enterprise value of the franchisor despite their potential advantage in recruitment. When the franchise system is sold, the buyer of the system will value the continuing revenue stream available, and sharing of royalties with an area representative will reduce the value of the system to the buyer.

Area reps also are focused more on expansion and less on supporting the franchisees. Should that occur, the franchised businesses in their area — if not in the entire franchise system — suffer, and there is the potential for a higher level of closures and litigation.

There are ways to address some of the downsides of an area representative relationship by structuring the rep's role and modifying their fee arrangement to be based on the performance of the locations in their area. Still given the downside risks and the availability of alternative growth strategies, we would expect the use of area representatives to continue to decline.

Figure 2-4 displays the typical area representative relationship.

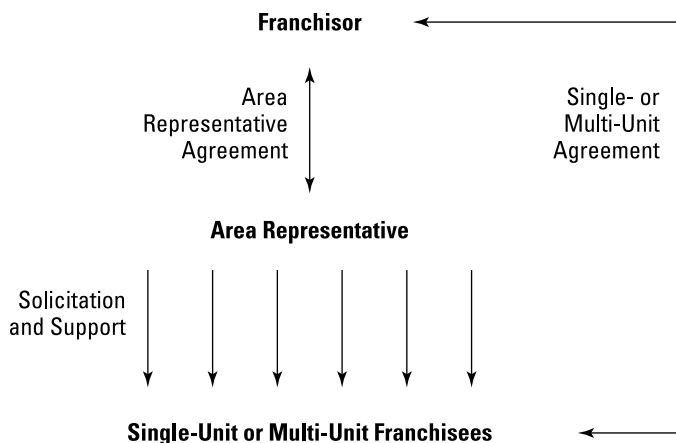


FIGURE 2-4:
The area representative family tree.

© John Wiley & Sons, Inc.

Sharing Risks and Rewards in a Joint Venture

Think of a joint venture as a form of partnership between a franchisor and a franchisee. Different from a standard franchisor-franchisee relationship, generally each party contributes assets to the joint venture, and each shares in the profits and losses of the entity they form. What each party contributes will vary greatly from one joint-venture relationship to another.

In a simple joint-venture relationship found in franchising, the franchisor identifies a strong operator as its joint-venture partner. The franchisee and the franchisor (the franchisor usually establishes a subsidiary or separate entity for this purpose) form a joint-venture entity, and that entity signs a franchise agreement with the franchisor. The franchisee participant operates the franchise for the joint venture and earns a separate fee for doing so. The franchise agreement is a

standard agreement, and generally the fees and obligations are the same as with any other franchisee.

The joint-venture agreement will also define the rights and obligations of each party as you would find in any partnership agreement. Common elements would include limitations or restrictions on the franchisee joint-venture partner to dispose of certain assets, acquire debt, or take other specified actions. Formulas or methods are also included to allow for cross defaults and, most importantly, how to unravel the relationship, should that be required.

Several franchisors have used joint-venture relationships both in the United States and as part of their international expansion, but it is not a common structure because it is complicated, somewhat difficult to manage, and creates difficulties should the relationship need to be terminated and unwound.

Councils, Associations, Cooperatives, and Buying Groups

Most modern franchise systems will establish at some point a franchisee advisory council (FAC). Whether elected by the franchisees in the system or appointed by the franchisor, the purpose of the FAC is to be a sounding board for the franchisor. Although the FAC doesn't have any decision-making powers, it's an important part of most franchisors' processes for evaluating changes to the system, recommending improvements to the system, and testing new ideas by obtaining the input of operating franchisees.

Associations, cooperatives, and buying groups are different. These groups are generally formed either independently by franchisees or in conjunction with the franchisor and may be separate legal entities.

Historically, franchisee associations were created when some event occurred that put the franchisees and the franchisor at odds with each other. In most instances the franchisees would join the association and pay dues. Generally, the first hire of the franchisee association would be an attorney to represent the association in discussions or litigation with the franchisor. Franchisee associations were therefore not looked upon fondly by franchisors — were seen as sort of a franchisee union — and the nature of the relationship was often contentious. As franchising has matured, many franchisors have established beneficial relationships with

franchisee associations, although most franchisors still prefer to work through their FAC and not through a franchisee association.

A buying group or cooperative is established to provide cost savings opportunities for participating franchisees by fully exploiting the buying power of the many franchisees operating in a franchise system. Typically, the buying group or purchasing cooperative negotiates supplier arrangements and facilitates its members' purchases on uniform pricing and delivery terms.

Reliance on buying groups and cooperatives is especially common in the food sector, but they exist across all industries. A well-managed buying entity will ordinarily generate significant cost savings, and for that reason franchise systems that embrace these groups often enjoy a competitive advantage.



REMEMBER

It is important to understand that franchisees who participate in these groups are still required to follow the franchisor's brand standards and specifications. For this reason, franchisors often exercise significant influence over quality and other standards applicable to selection of products and the suppliers themselves. Some franchisors even participate directly in the groups, to better service the franchisor's corporate (non-franchised) locations. For more on buying groups and cooperatives, see Chapter 9.

Buying Franchisor-Owned Locations



REMEMBER

On occasion, franchisors make company-owned locations available for sale to franchisees. This is called either *retrofranchising* (locations that have never been franchised) or *refranchising* (locations that once were franchised but were acquired and operated by the franchisor). For all practical purposes, for franchisees looking to invest in established businesses, they are the same.

Franchisors have many reasons for wanting to sell company-owned locations:

- » They may no longer fit the franchisor's strategic plan.
- » The franchisor may want to consolidate the number of markets or number of locations it directly operates.
- » The franchisor wants to stimulate the development of additional units in a market, and providing franchisees with cash flow from established units is part of that strategy.

- » The franchisor may simply need the proceeds from the sale.

In some situations, franchisees are just better at operating locations than the franchisor, and the franchisor is selling locations simply because it believes the locations work better under the control of a franchisee than under the franchisor's own personnel.

Acquiring an existing location from another franchisee or from the franchisor has many advantages:

- » It shortens the time to get the business up and running because you don't have to find the location or work through constructing and equipping the business — and it already may have a trained staff and management team.
- » Bank financing may be easier because the business exists.
- » The seller may offer seller financing, and a motivated seller might be willing to cut you a good deal.
- » You are buying a business that currently is operating, has existing customers and an established cash flow, and you know the performance of the operating business. Your investment decision is based on current operations and not on projections.
- » If the location is being sold by the franchisor, it can share with you the financials for the location, even if it doesn't include an Item 19 Financial Performance Representation in the FDD (see Chapter 6).

As with any purchase, you should take your time to evaluate the business. Sometimes you will find franchisors that are churning locations. *Churning* occurs when a franchisor is selling a company-owned location that it may have taken back from a franchisee because the unit is failing or has failed. If the unit wasn't viable before, there is a good chance it won't be viable under new ownership either and likely should have been closed. Churning frequently happens in some systems where the franchisor is trying to avoid disclosing in the FDD a unit failure and instead buys a failing location before it closes.



TIP

Always get a history of ownership of any business you are looking to purchase. Don't assume that you are a smarter or better operator than the last guy. A franchisor that has a high percentage of churning may offer little chance for success to any type of franchisee and so may not be a sound franchise investment — even for franchisees not buying one of these recycled locations. Thankfully, not many franchisors churn their locations, but you still have to be alert to the possibility.

CONVERSION AND NONTRADITIONAL FRANCHISES

A less common alternative to the traditional franchise relationship is a *conversion* franchise, in which an independent operator, in the same business as the franchise system, converts its operation substantially to the franchise system. For example, an operator of a local pizza restaurant completes remodeling and modification of its menu to operate as a Pie Five Pizza under a franchise agreement. In a conversion franchise, the new franchisee may execute a franchise agreement that has some material differences from the franchisor's standard agreement, including fees and a transition plan to convert their existing business over to the franchise system's retail offering.

Other variations of the standard franchise fall into a broad category usually referred to as *nontraditional locations*, including mass-gathering locations — airports, train stations, hospitals, college campuses, sports stadiums, ballparks, food courts, portable kiosks in parks and amusement parks, military bases, and so forth — where traffic to your business is generated by someone else's customers. Also included in this area are locations found in host locations, such as convenience stores, big-box retailers, and so on. These types of locations are generally not available to the average franchisee, and it is common for a franchisor, even when it is giving the franchisee some territorial rights to carve out these locations from the franchisee's protected territory.

- » Assessing whether franchising is right for you
- » Understanding the advantages and disadvantages of investing in a franchise
- » Recognizing the differences among franchisees, entrepreneurs, and employees

Chapter 3

Mirror, Mirror, on the Wall

You need to define who you really are and what you want to do. Self-evaluation may be the most difficult thing for anyone to do when they are caught up in the excitement of striking out on their own. However, at this point in your evaluation of franchising, it is essential that you be brutally honest with yourself. Your future happiness depends on being able to make an honest assessment about yourself.

Most individuals looking to invest in a franchise will have an emotional reaction to the process of selecting one. That should not be surprising because when we train franchise salespeople, part of the training is to make certain they build an emotional bond between the candidate and the opportunity. But remember, you don't *need* to become a franchisee and you should stay above the emotional fray and only make your franchise decisions based solely on the merit of the offering.

Every franchise salesperson or franchise broker is going to tell you that you are perfect for their franchise opportunity. Their job is to sell you the opportunity they are offering because that's how they make their living — they're only paid their commission when you sign the franchise agreement.

This chapter will help you define who you are and whether you're the type of person who should be investing in a franchise. Your decision needs to focus on you: your lifestyle, family, likes and dislikes, work rhythms, values, ethics, and even dreams. If you're not absolutely comfortable — for any reason — with one franchise opportunity, remember that there are hundreds more for you to consider. And you should. Franchising will not make you a new person, and it is not a self-help tool.

Starting Your Own or Joining a Team

Franchising is not the right choice for some people. Although franchisees manage nearly every aspect of their businesses on a day-to-day basis, and how they establish their human resource policies and supervise their employees are 100 percent in their hands, they still need to operate and deliver on the brand promise set by their franchisor. This duality of business ownership and not being in control of the brand standards or what products and services can be offered to consumers can cause difficulty for some individuals.



REMEMBER

A franchisee is *not* buying a franchise. They are investing in the right to use the business system of their franchisor. The only thing they are buying is the hard assets necessary to start and support their business.

New business owners have a choice to make: They can choose to become an independent business owner and steer their own course, or they can invest in a franchise opportunity. If they choose the latter, the products and services they will be selling and how they sell them will be decided by someone else. As discussed in Chapter 1, successful franchisees are not entrepreneurs yet still need to exhibit entrepreneurial qualities. In franchising, that preferential profile is called a *formula entrepreneur*. Deciding on whether to start your own business or becoming a franchisee depends on a lot of factors — most important is your personality.

If independent decisions and your needing to make the decisions on every detail of a project are essential to you, you likely should start your own business and not become a franchise. If it's essential to you to create every element, and deep down you know you will have difficulty following someone else's direction — especially when you may not agree with them — franchising is not right for you.

Maybe you might make a better franchisor than franchisee if you have an innovative product or cutting-edge service that is currently not being offered to consumers, or you have a better way than what's currently available in the market for providing an established product or service, you may be better off striking out on your own. You might even want to start your own franchise system, and if you do,

giving either of the co-authors of this book a call would be a logical path for you to take. However, the point we are trying to make is that although franchising can be an outstanding way to get into business, it's not right for everyone.

Consider the Pros and Cons

You may occasionally see franchisors or franchise brokers using generalized statistics about the success of franchising. These statistics were based on studies by the U.S. Department of Commerce or the U.S. Small Business Administration conducted in the 1980s and 1990s that misled potential franchisees by making them think franchising was a surefire, safe investment, regardless of the franchisor. The International Franchise Association has asked its members and the press to no longer quote those statistics.

Most franchisors will publish statistics about their own franchise systems, and that information can be instructive and very beneficial because a well-designed franchise program *can* be an exceptional investment. But cookie-cutter franchise systems that are poorly managed are not good investments and need to be avoided. If any franchisor or broker quotes from these out-of-date and misleading industry success statistics, our best recommendation is for you not to do business with them and move on. Most franchisors are legitimate businesses looking for qualified franchisees. These franchisors don't mislead prospective franchisees by quoting discredited industry statistics.

Let's instead consider some of the advantages and disadvantages of your making a franchise investment.

Advantages of making a franchise investment

Your chance of success in franchising can only be as strong as the franchise system you select and how well you manage your business. Well-structured and managed franchise systems that support their franchisees generally offer the benefits discussed in this section.

Overall competitive benefits

The public has become accustomed to a certain level of quality and consistency when shopping at any branded locations (see Chapter 2 for more on this phenomenon). What we mean by *branded location* is a business that the public thinks of as a *chain* because each location has the same name, décor, products, services,

menu items, and so on. In a branded location you expect that the customer experience will be the same regardless of the location.



REMEMBER

Whether a company's product is superior or mediocre, if its locations are successful, the secret for its success will likely be in its consistency. Great branded systems offer consumers consistent, sustainable replication of their brand promise, regardless of where you shop.

No matter where they are, even if they're overseas, consumers believe that they understand the level of quality they will receive when they shop at a branded location. This perception about branded chains gives new franchisees an established customer base on the day they open their doors — often even before they begin their retail advertising. Branding enables franchisees to compete with well-established, independent operators and even against other franchised and non-franchised chains.

The advantage of brand recognition can also extend to the ability of a franchisor to establish system accounts that benefit the franchise system. Companies and even government agencies frequently look for franchise systems that have a network of locations because they trust that each franchisee will operate at the same level of consistency and commitment. The franchisor will often establish system relationships, including the price that the business will pay for the products and services. In this way, the customer can have its needs serviced wherever the franchise system has a location.

Pre-opening benefits

Although the cost of entrance into a franchise system includes a franchise fee, often cited as a disadvantage, the franchisee that joins and pays the initial franchise fee can expect to benefit from the franchisor having tested operating systems that will be consistently applied in each location. The franchisee will receive initial and often advanced training for management and staff, operations manuals, marketing and advertising programs, site-selection tools, store design, construction programs, reduced cost of equipment, and other support necessary for them to successfully launch their business. Additionally, franchisees can ask their franchisor and a network of other franchisees in the system questions when issues come up.



TIP

Over time, most franchisees discover how valuable the advice other franchisees give can be. After all, they have likely faced the same issue you're having trouble with — and best of all, they had the same issue in the same exact business and franchise system you have joined.

Ongoing benefits

Once a franchisee is open, support from the franchisor's home office and *field consultants* (franchisor support personnel assigned to assist and consult with a franchisee) can be powerful. Because the franchisee is part of a system where everyone is buying the same inventory and other goods, the system can enjoy the purchasing power that comes from joining with others. This can often result in lowered operating costs. The franchisee benefits from professionally designed point of sale computer systems that help them track their sales and often their costs. Having professionally designed marketing materials, advertising, grand-opening programs, and other marketing materials that independents could never afford is a major advantage. Also, with multiple franchisees in a market, the ability to advertise is enhanced because the cost is shared across the locations in the system. Franchise systems have the ability to test and modernize their products and services to keep ahead of the competition that smaller independent businesses simply couldn't afford. In addition, when a franchisor can establish critical mass in a market by developing multiple locations, franchise systems can dominate local markets.

Disadvantages of making a franchise investment

Before investing in any franchise you need to understand some of the disadvantages that come in a franchise relationship.

Loss of independence

For some people, one of the most serious disadvantages of becoming a franchisee is their loss of independence. As we mentioned earlier, if you need to make all your own decisions about the products and services your business will be selling, franchising is likely the wrong choice for you. Franchise systems are structured in such a way that the franchisor sets the rules and the franchisee will independently manage their business to meet the franchisor's brand standards included in the franchise system's manual.

Overdependence on the system

Loss of independence, if taken to extremes, leads to another disadvantage: overdependence on the franchise system. Franchising succeeds when financial and emotional risks motivate franchisees to take the franchise system and execute it better. Great franchisees do not change the system — they simply deliver better on the franchisor's brand promise.

However, when franchisees need to totally rely on the system for their success, and cannot independently manage their business on a day-to-day basis, their

overdependence can cause problems. Franchisees need to balance system restrictions with their personal ability to manage their own businesses. For example, when a franchisee depends on national advertising exclusively and does not invest in local marketing, they are shortchanging their business by relying too heavily on what the franchisor is bringing to the party. If every time an issue comes up, they cannot independently make decisions and instead call the franchisor or another franchisee for advice, all parties are going to suffer.

Other franchisees who are “bad apples”

The principal reason for the success of franchising, as we’ve said, is the public’s perception of quality and consistency throughout the chain. When the public receives great service at one location, the assumption is that the system has great service at every location. This consumer expectation is also one of the potential major frailties of any chain, including franchising. Franchisees are judged not only by *their* performance but also by the performance of other franchisees.



WARNING

Poorly performing fellow franchisees or company-owned locations can damage a franchisee’s business even where they do not share the same market. If the hotel room is dirty in one location or, even worse, if the press reports that the hotel has rodents, the public assumes that the problem exists throughout the system.

Consider how you feel about a brand when one or more locations across the country have a problem reported on Yelp or other social media sites. Because of the Internet and social media, no brand today is truly local, and what happens across the country or even across the ocean is going to impact how the public views your local operation. We discuss how franchise systems deal with social media comments in Chapter 11.

Elevated income expectations

Although good franchisors and franchise sales staff try to prevent it, some potential franchisees have unrealistic expectations about the income they are going to earn. If a franchisee’s earnings expectations are unrealistic, they will regret their investment in dollars, time, and effort and may become a negative influence on the system. Having realistic expectations is important to any investment decision. It is essential, therefore, that you carefully prepare for yourself financial projections for your business to determine whether or not the franchise you are evaluating can meet your financial needs.

Because of the rules that govern franchising, franchisors are often restricted from commenting on the financial projections prepared by prospective franchisees. Doing so may put them outside the boundaries established by the FTC’s Franchise Rule governing financial performance representations. A franchisee with their

advisors should base projections on realistic expectations and information gained through the franchisor's disclosure document, the Internet, and other franchisees and other sources.

Franchising inelasticity

Franchise systems are bound together through the legal agreements between the franchisor and each franchisee and developer. Often, these agreements contain restrictions that potentially impact the franchisor's ability to make strategic decisions. For example, if an independent nonfranchised business finds a perfect location for a new store, it is free to open at that location. In a franchise system, the franchisor must first look to the legal agreements between itself and the franchisees in the market to see if that new location will encroach on any franchisees contractual rights. If the franchisor has granted the franchisees protected territories, and the potential location is in one of those territories, the franchise system may lose that market opportunity — and will often lose that location to a competitor who does not have the same restrictions. A similar situation can arise if the new product or service the franchisor wants to introduce into the system requires the franchisee to make a capital investment and the franchisee does not have the contractual obligation to do so.

The franchise agreement

Every franchise agreement contains rights and obligations that both the franchisee and franchisor have agreed to meet. For the franchisee, the agreement can contain provisions they need to understand before they sign on the dotted line.

These rights and obligations can be a double-edged sword. Sometimes they can make franchising successful, but sometimes they can also be disadvantages to some franchisees. The restrictions may be on the product and services they are allowed to offer, limitations on size and exclusivity of their territory, the possibility of termination for failure to follow the system, the added investment often required for reimagining, remodeling, or new equipment as a condition of renewal, the cost of transfer and renewal, and restrictions on independent marketing. Also, the added costs for royalties, advertising, additional training, and other services potentially reduce a franchisee's earnings.



WARNING

Many franchisors today are reducing the size of the territory they grant to franchisees. Some grant exclusivity for only a short period of time, and others are eliminating protected territories altogether. In the long run, having a fully developed market is a benefit to the franchise system, although it may have an impact on a particular unit in sales.

Being Realistic about Being a Franchisee

Even in great franchise systems, some franchisees do better than others and some franchisees are dismal failures. How is that possible if successful franchising is about franchisors providing great systems that can be executed consistently? The reasons have a lot to do with the human factor.

Franchisees are not robots that can be fed a string of commands that they execute flawlessly in every situation. Nor do franchisees have the flexibility to make every decision for themselves. Remember, franchisees are business owners that signed up to follow the formula of the franchisor.

As a franchisee, you are an independent business owner with the responsibility to manage your business on a day-to-day and minute-to-minute basis. You are responsible for supervising your management and staff and decide on the human resource policies you want for your business. But as a franchisee, you need to do all that while applying the system that the franchisor licensed to you. Having a clear understanding of the franchisee/franchisor relationship is vitally important.

Consider these potential advantages and disadvantages of the franchising arrangement and gauge your reaction:

- » The franchisor's standards on products and services may seem restrictive, but they provide the public with assurance on the consistency of the brand.
- » Providing you with limited or no protected territory may reduce your market, but doing so allows for the development of other franchise and company-owned locations in the area. These locations can contribute with you to the advertising fund, which will enhance the local name recognition of your business.
- » Additional locations close to yours may seem to be competing with you for your customers. But by working together with other franchisees, you can increase your effectiveness against the competition by reducing the costs of goods through buying cooperatives, jointly recruiting personnel, and creating improved brand awareness because customers see the system's trade name more frequently.
- » The possibility of being terminated for failure to follow the system may seem unfair, but keep in mind that those same penalties may be imposed on other franchisees who may not perform as well as you do. Because franchisees are part of a branded system, customers may view you in the same light as those poor operators, which can have a dramatic effect on your success (or lack of it).



TIP

Make a list of those standards you feel are unfair for a franchisor to use to terminate your franchise. Then consider that if the franchisor doesn't have the right to terminate you for not following those standards, it won't be able to terminate another franchisee either. Discuss in advance with the franchisor those standards you don't anticipate following, and if you have such a list, don't be surprised if the franchisor fails to offer you a franchise. By the way, if you have such a list, you likely should reevaluate your ability to be a franchisee.



REMEMBER

Franchisees execute the system that the franchisor provides. Great franchisees take that system and improve it by providing excellent customer service, by hiring and training quality people, and by creating an atmosphere in their businesses that is palpably better than expected by their staff, customers, vendors, and the franchisors. Great franchisees enhance the basic system by simply executing the basics better each and every day.

Looking in the Mirror: A Self-Evaluation

Only you can tell if franchising is right for you — it's a personal decision. You don't need to score yourself on the questions we pose in this section because no one element is really more important than any other, and less than a 100 percent doesn't mean you won't be a perfect franchisee.

These are basic questions, and others will likely come to mind. Trust that little voice inside your head that wakes you up at night, because that little voice deserves to have its questions answered too.

Are you willing and able to learn new skills?

As a new franchisee you have a lot to learn, and every day you are also going to have to be a teacher, mentor, and monitor — teaching your employees how to operate the business, motivating them to succeed, and monitoring how well they are serving your customers.



REMEMBER

Your franchisor sets brand standards. It will provide you with the tools to help you train your staff, manage your business, serve your customers, and maintain the safety and security of your operations. The franchisor will also provide you with an operations manual and support you with field consultants. But it's still your sole responsibility to deliver to the consumer the franchise system's brand promise.

Training is important to franchisors — so important that most franchisors include a clause in their franchise agreements giving them the right to terminate you as a franchisee if you can't pass their initial training class. Most will also require that you bring your management team to initial training. Your eagerness to learn new skills is an important attribute of becoming a franchisee.

Part of what franchisors will look for is your ability to set aside your preconceived notions of how you might want to operate the business and see if you will operate it as *they* want you to. This requirement can be especially hard for those operators who are converting established independent businesses to the franchisor's brand and operating methods.

Would you rather give or take orders?

Everyone has their own ideas about giving and taking orders. If you bristle at the thought of having to report your sales and expenses monthly or even weekly, or at being told how to set up your merchandise, what ads to run, and how to display point of sale banners, think about how you will feel when you are expected to follow an entire system every day. That is, day in and day out — year after year.

Following a detailed structure that allows you to deliver on the franchise system's brand promise is your best ticket to success. You are investing in your franchisor's formula, and your role is to execute the system the franchisor provides to you. That means you need to follow the rules and work within the agreed-upon system. Ask yourself the following:

- » Even when you think you have a better way will you be able to follow the system?
- » Will you be able to accept coaching and advice from the franchisor's field and headquarters staff?
- » Do you view yourself as a creative genius or will you be willing to only use the advertising and promotional material provided by the franchisor?
- » Do you think your local market is different from all others in the system and do you expect the franchisor to let you make those changes after you are on board?
- » Can you accept (with some honest skepticism) that your franchisor is working for the benefit of the entire system — even when its decisions don't necessarily go your way?
- » Are you willing to share financial and performance information with the franchisor and its field staff?
- » Do you have the personal drive to be a great operator?

How you answer each question is important to making your franchise decision.

Everyone in a franchise system starts with the same tools, but the great ones add their personal skills, drive, and personalities to improve the performance of their business. Still, great franchisees understand that consumers expect consistency from location to location, and consistency requires you to make changes without the franchisor's permission.

Can you say goodbye to corporate perks?

Perhaps the biggest adjustment middle managers face as franchisees is the loss of many of the support services they had grown accustomed to. Their administrative assistants probably did not come with them when they left their job. And the copy machines, fax machines, filing systems, payroll clerks, legal department staff, computers, and travel services are probably also at the office where they left them. Although you are not in business by yourself as a franchisee, sometimes you will feel like you are.

As a former corporate executive, you may have a broad understanding of business, know how to work within a system, understand how to motivate staff, and are no stranger to long hours. But likely you never started a new small business.

Certainly, a structured franchised system will replace some of the support you once had, and that should make the transition to independent business ownership easier. But overall, how well you run your business will depend on your efforts.

Some of the services franchisors may have historically provided to franchisees are quickly going away. These may have included preparing the franchisees' payroll and providing training to their franchisees' staff. The reason this is happening is because of some of the actions of the National Labor Relations Board and the Department of Labor in how they have re-defined joint employment and independent contractors. Stay tuned to changes that are taking place in Washington. These changes are now being challenged, and those services may begin to reappear within some franchise systems.

How is your health?

The demands of running any small business often require that you have an extraordinary level of staying power. Even when an extra ten minutes of sleep in the morning is what your body craves, you must get up, open your business, and serve your customers. To achieve that level of endurance, you have to be in good health. Do you have the physical ability to meet the needs of operating your own business? Can you handle stress?

FRANCHISING FOR VETERANS

Franchisors have always recognized that military veterans often make very successful franchisees. Veterans understand the need to follow a structured and ordered system. But what makes the U.S. military the best in the world is the capability of our military personnel to take the system given to them and execute better than anyone else on the planet. This is exactly the skill and temperament franchisors look for in great franchisees.

Because veterans frequently make outstanding franchisees, and also to thank the men and women who have bravely served our nation, the International Franchise Association (IFA) has established a program called VetFran. Today, through franchisors that participate in VetFran, veterans are rewarded with financial benefits and other support that may not be available to other franchisees. The U.S. Department of Veterans Affairs, the U.S. Small Business Administration, and the Veterans Corporation also provide support for VetFran.

"I have been privileged to put into business or be responsible for over 10,000 franchisees. Some of the very best have come from the ranks of our military through the VetFran program," says James Amos, CEO of the National Center for Policy Analysis and a 2012 IFA Hall of Fame inductee.

For information on VetFran and the Veterans Scholarship program, go to www.franchise.org.

Especially during the early days as a franchisee, as you learn your new craft, things will not always go exactly as you expect them to. On an almost continual basis, as a business operator, you will need to deal with crisis issues and deadlines that will become stressful. How is your coping mechanism? Do you have the mental ability to meet the everyday needs of operating your own business?

Do you like people?

Do you *really* like people? This question may sound silly, and your response is likely, "Of course I like people."

We are talking about *relationships*, because franchising is based on relationships. As a franchisee, you will need to maintain relationships with your franchisor, staff, customers, and vendors. Similarly, your family and personal support network will influence your franchise's performance.

You are going to need the ability to communicate and to listen. Every business owner must interact with a wide array of people during the course of every business day — but especially within a franchising environment, you need to understand that you are not working alone. Interacting positively with fellow franchisees, your franchisor, your staff, and your customers is important every day you do business.

How much can you dish out and take on?

Having enough money to invest in your franchise and to purchase the necessary equipment and stock is not enough. Even if you're prepared to invest what the franchisor predicts is required, you need to be prepared to invest some more. Things don't always go by the book, and all the franchisor provided to you was an estimate of what you will need.

Going into business shouldn't cause you to put all your financial resources at risk, because all may not be enough. Examine your finances and make certain you have enough to live on if your business can't support you and your family in the early days. Put that amount aside. Be certain the important things like food, housing, and college funds for the kids are protected. In short, you need to have adequate resources available.



TIP

Be disciplined and work with a financial advisor or an accountant. These are the professionals that can help you determine how much you can afford to invest. Ask your friends and neighbors if they know a good Certified Public Accountant (CPA) who can help you through the process. You can also contact your local CPA association for recommendations. (See Chapter 4 for a discussion on how to find professional advisors.)

Consider your family and friends

Operating a business is more than a full-time job, and during its startup phase, a franchise can *become* your life. You can expect to need to carve out time you normally might spend with your family and friends and pour it into your business. If your family and friends resent the time you must dedicate to the business, that can cause you to become stressed. But we don't know many successful corporate executives or workers who punch a clock and work multiple jobs who are not also regularly putting in a 70-hour workweek. Talk to your friends about how your time availability will change.

Select an industry that meets your personal needs and likes. If you will be embarrassed to tell friends and family that you own a janitorial business or a moving

company, even if such businesses are highly lucrative, do not invest in one. If working 12-hour days, 7 days a week is not your idea of fun, make sure that the franchise industry you select offers better hours. Whether you need \$50,000 or \$200,000 a year to support your family, make sure that the other franchisees in the system you select are making that type of return.

Personal happiness is important, and with over 120 different industries and thousands of franchise opportunities available, one of them is likely to suit your needs. Include your family in your preliminary and ongoing investigations into franchising and get their support. This way, when you need their support — and you will — they will feel invested in the process and can give you the support you need.

IN THIS CHAPTER

- » Understanding a franchisor's mandatory disclosure obligations to prospective franchisees
- » Reviewing and evaluating a franchise disclosure document (FDD)
- » Using the right professional advisors to help you
- » Negotiating with the franchisor — what's reasonable, what's not, and why

Chapter 4

The Legal Issues

In this chapter, we discuss the Franchise Rule published by the Federal Trade Commission (FTC). In franchise circles it is also known as the *FTC Rule* or simply *the Rule*. It sets forth requirements for the franchise disclosure document (FDD) franchisors are required to provide to prospective franchisees in advance of signing the franchise agreement. If it were only so simple as to have only one set of rules. To understand franchise law we will also need to examine state franchise laws and the requirement in some states to register, or file the FDD before a franchisor can offer franchises in a handful of states. Even once we address the federal and state requirements, we will be leaving out a fairly large body of case law and standards of practice in franchising — but we promise you, we are going to give you the highlights.

Under the FTC Rule, franchisors are generally required to prepare and provide to prospective franchisees a disclosure document called a *franchise disclosure document* (FDD) in advance of entering into any franchise agreement. In a prescribed format, franchisors are required to provide specified types of information so that prospective franchisees can make an informed decision before investing in a particular franchise.



TIP

Not *all* of the information you will require will be found in a franchisor's FDD, so use it as a jumping-off point in your exploration of any franchisor. Most important: Follow the FTC's admonition to engage the services of qualified professionals in completing your investigation. Hiring pros can add to your investment, but

you wouldn't consider parachuting out of an airplane without a qualified instructor, would you? Likewise, you should never become a franchisee without the aid of a qualified franchise lawyer.

As Paul V. Russell, senior counsel at 7-Eleven, Inc., explains, “Franchisors spend significant time and resources creating their brands, and they typically take appropriate precautions to protect and enforce their brand standards. Prospective franchisees would be wise to exercise similar caution by engaging an experienced franchise lawyer who can help them better understand the information in the FDD, as well as the obligations of each party under the franchise agreement. Prospective franchisees who exercise prudence and caution prior to entering into a franchise relationship can better protect themselves from unnecessary disappointment and cost down the road.”

Franchise Regulation: A Little History

Chapter 1 explores a bit about the history of franchising, but if you're looking for the beginning of *modern* franchising and modern franchise regulations in the United States, the starting point has to be 1946 when Congress passed the Federal (Lanham) Trademark Act. The Lanham Act granted licensors the ability to license their intellectual property and established the rules they need to follow.

Under the Lanham Act, a licensor (franchisor) can license its federally registered trademarks and service marks to others without risking the possible loss of its intellectual property. The ability of independently owned businesses to offer products and services licensed to them by franchisors is the essential cornerstone of every franchise system. Over the next 20 years, brands like Dunkin' Donuts, Kentucky Fried Chicken (now KFC), Burger King, McDonald's, Midas, Holiday Inn, H&R Block, International House of Pancakes, and 7-Eleven begin to dot the landscape of America.

Still, *how* franchisors offered their franchise opportunities to prospective franchisees was substantially unregulated, and with rapid growth, problems arose. By the late 1960s, the bloom had left the rose. Some franchisors began to focus more on selling as many franchises as they could rather than on their obligations to their franchisees and customers. In the process, their existing franchisees often received diminished support from the franchisor.

Some franchisors misrepresented the resources and success that their franchise offerings had achieved in an attempt to attract more franchisees. In some cases, some franchisors sold franchises for business concepts that didn't even exist, and others used the names and endorsements of celebrities to attract buyers. There

were even franchise opportunities that guaranteed you would get rich if you invested in their chinchilla farm opportunity.

As a result litigation followed, and soon there were federal and state hearings. Several states including Delaware, California, New Jersey, and Washington enacted laws governing the pre-sale disclosure of information to potential franchisees. Other states soon followed.

It wasn't until 1979 that the Federal Trade Commission (FTC) implemented the FTC Rule throughout the United States and its territories, including American Samoa, Guam, Puerto Rico, and the Virgin Islands. The format and content of the FDD has undergone changes over the years meant to strengthen presale disclosure to prospective franchisees. The last major change took place in 2007, and we expect that the FTC will begin a lengthy review of the existing disclosure format in 2017.

The State Regulatory Landscape

There is no requirement for a franchisor to register its FDD with the federal government or get any approval from Washington, D.C. before it begins to offer its franchise. All a franchisor needs to do to satisfy the requirements of the FTC Rule is prepare the mandated disclosure document and provide it in a timely fashion to prospective franchisees.

However, 14 states require a franchisor to submit to them their disclosure document for review and to register or make filings with the state before commencing any franchise sales activities in their state. The states that require registration include California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin. Other states including Utah, Texas, Nebraska, Kentucky, Florida, and Connecticut, have business-opportunity laws that require a franchisor to file a notice with the state but do not require a franchisor to register or file its FDD with a state agency.

A second set of state laws — generally referred to as the franchise *relationship laws* — are intended to give added protection to the franchisee from certain actions of the franchisor, including arbitrary termination of the franchise or nonrenewal of the franchise at the end of its term. Some also grant franchisees the right to form independent franchisee associations, enabling franchisees to collectively discuss issues with their franchisor. The FTC Rule and federal law (excluding certain industry laws like automobile and petroleum franchises) don't encroach on the franchisor-franchisee relationship like some of the state regulations.

Finally, although the Federal Trade Commission defines what makes a license a franchise under federal law, some states have additional requirements that broaden the definition of what is considered a franchise in their state.

The Franchise Disclosure Document

The purpose of the FDD is to provide prospective franchisees with information on the franchisor, the franchise system, and the agreements they will be required to sign before they are allowed to become a franchisee. The purpose of the FDD is to enable a prospective franchisee to make an informed investment decision.

The FDD is only part of the information a prospective franchisee needs, and that's why it is important for prospective franchisees to work with qualified franchise lawyers and consultants in evaluating any franchisor's FDD and every franchise opportunity.

Franchisors are required to update their FDDs within 120 days after the end of their fiscal year, and may be required to update the FDD on a quarterly basis or sooner if there have been any material changes to the franchise system or the information in the franchisor's disclosures.

What you will find in the FDD

The FDD is long, and new franchisees will find terms that sound familiar but might not mean what you think they do — and that after the FTC required it be prepared in “plain English.” Not counting the cover page, the FDD contains 22 areas of disclosure—referred to as Items—and a receipt. The receipt page is important because it details the date the disclosure document was provided to the prospective franchisee so that both the franchisor and franchisee know when the mandated waiting period before a franchise agreement can be signed has ended.

According to the FTC, franchisors are required to make material disclosures in five categories:

1. The nature of the franchisor and the franchise system
2. The franchisor's financial viability
3. The costs involved in purchasing and operating a franchised outlet
4. The terms and conditions that govern the franchise relationship
5. The names and addresses of current franchisees who can share their experiences

In addition, if a franchisor elects to provide prospective franchisees with a financial performance representation, the franchisors must have a reasonable basis and substantiation for any of the information provided and allow the franchisee to review the franchisor's substantiation.

The waiting period

"I've completed my research, visited the franchisor, received a copy of the FDD, read and understood the agreement, and made my decision. I want the franchise now. Why can't I sign the franchise agreement today?" The answer: The law requires a waiting period referred to as the *14-day rule*.

A franchisor is required to wait a minimum of 14 calendar days after delivering to a prospective franchisee its FDD before allowing a prospective franchisee to sign the franchise agreement or pay the franchisor any money. The clock starts ticking once you have received the disclosure document and have signed the receipt. If you would like to receive a copy of the FDD earlier than 14 days before signing the franchise agreement, just ask for it.



TIP

You may receive a copy of the FDD by memory stick, CD-ROM, e-mail, or Internet download. It's going to be long, perhaps more than 200 pages, and may be 6 MB in size. If your computer or network system can't efficiently download a document of that size, or if you just can't bear to read the document on a screen, you have the right to request a paper copy from the franchisor.

Once you and the franchisor have begun to discuss you becoming a franchisee, upon reasonable request you are entitled to receive the FDD either in printed or electronic format. The purpose of the 14-day rule is to give you time to think about your decision to become a franchisee, and you should take your time reviewing and understanding what is included.

The FTC Rule also requires a seven-day waiting period for the franchise agreement under some circumstances. If the franchisor makes unilateral changes to the form of the franchise agreement provided in the FDD or includes information in the final agreement that you have not had a chance to review, then the franchisor must provide you with the completed franchise agreement at least seven calendar days before signing. This gives you time to review and consider the revised terms of the agreement. Not to get too technical, if the changes to the agreement benefit you, then you may not need to wait another seven days.

These rules serve an important purpose. When you initially make the decision to invest in a franchise opportunity, your enthusiasm for the deal generally runs high. Becoming a franchisee can often be a very emotional decision and a talented franchise salesperson can make it almost feel like investing in the franchise is the

most important thing you can do. The 14-day and 7-day delays allow you time to reflect on your decision and give you and your advisors time to conduct a proper due diligence. Once you sign the agreement, even if you haven't consulted with a lawyer, you're going to be obligated by the contract you sign. With an investment as important and sometimes as complicated as a franchise, spending the money on a qualified franchise lawyer to help you make your decision is essential.

The FDD, Item by Item

Just because every FDD contains the same 22 Items of disclosure (and receipt) doesn't mean that the information contained in every FDD will be the same. Franchise offerings, even in the same industry, contain significantly different terms, and you should understand what the franchisor is offering.

To make it easier for you, the FTC requires that franchisors use "plain English" in drafting their FDD so that it's easier for you to read and understand. Remember that a very skilled attorney who works for the franchisor wrote the documents, so don't become lulled into believing that you understand "plain English."



WARNING

Experience tells us that many of the terms in an FDD can still be confusing to a franchising novice and even to lawyers and business advisors who don't specialize in franchising. That's why we recommend you have a qualified franchise lawyer working with you help you understand all the terms contained in the FDD. Your uncle Alex who wrote your will or helped you close on your house likely will not be well versed in franchising and franchise law and may cost you a good deal as a result.

The cover page(s)

The cover page(s) of the FDD contain interesting information that every prospective franchisee should read and understand:

- » It summarizes the franchise offering and the initial investment the franchisee is required to make.
- » It states that no government agency has verified the information in the document.
- » It reminds you to read carefully the entire document and all the accompanying agreements and recommends that you learn about the franchising laws in your state.
- » It suggests that you show the FDD and the franchise agreement to an advisor, such as a lawyer or accountant and identifies the person at the franchisor from whom you can request a copy.

Some states also require a separate cover page that contains information on some of the risks a franchisee should know about before signing the franchise agreement, including the following:

- » **Choice of law that governs the franchise agreement:** The franchisor will likely select the laws of its home state to govern the franchise agreement, not the laws in your home state. Some states do not allow a franchisor to pick its home state and/or require the franchisor to use the home state of the franchisee.
- » **Choice of where the franchisee may sue the franchisor:** If a dispute occurs, the franchisee may have to sue the franchisor in the franchisor's home state, requiring the franchisee to incur the cost of travel and other added costs. Some franchisee advocates believe this gives the franchisor a home-field advantage.
- » **The inclusion of arbitration as a method to solve disputes:** In some systems, a franchisee may not be able to sue a franchisor but must instead bring the dispute to an arbitrator or use some other method of dispute resolution. The benefits and disadvantages of the use of arbitration in franchising is a hotly debated issue.
- » **Information regarding the franchisor's financial condition:** This information will refer you to the franchisor's audited financial statements, where you can learn more about the franchisor's ability to meet its obligations to you and other franchisees in the system.

Just because a state has registered the franchisor's franchise offering, it does not mean that the state has verified the information or is endorsing the franchise. Although state franchise regulators will require franchisors to meet certain regulatory standards and answer questions about the offering, and may even require certain changes to franchise documents before allowing a franchisor to offer franchises in their state, regulators do not set the terms of the relationship between the franchisor and franchisee. Rather, the franchisor establishes the terms, and you can decide to accept them or reject them.

The following are the highlights (not all subtopics are included) of the 22 Items required for disclosure. The receipt page is often called the 23rd Item.

Item 1: The franchisor and its parents, predecessors, and affiliates

In Item 1 the franchisor provides a description of the company and the franchise being offered as follows:

- » The name of the franchisor, its parents, predecessors, and affiliates
- » The name under which the franchisor does business

- »» The franchisor’s address
- »» The state of incorporation of the franchisor and the type of business organization (partnership and so on) of the franchisor
- »» The franchisor’s business and the type of franchise to be offered
- »» The prior business experience of the franchisor, its predecessor, and its affiliates
- »» Information related to any governmental regulation of the franchisor’s industry

The FDD includes information related to the franchisor’s parent company, but you may only see the name and address of the parent company unless the parent is a franchisor of another franchise concept, provides a guarantee of the performance of the franchisor, or sells products or services to franchisees of the franchise system, in which case more information will be provided.

The franchisor must also disclose information regarding its affiliates and predecessors (for example, a person who operated or franchised the same type of business as the franchisor and from whom the franchisor acquired the majority of the person’s assets), including its affiliates’ and predecessors’ principal business addresses, business backgrounds, length of time selling franchises, and any other businesses in which they are involved.

Item 2: Business experience

In Item 2, the prospective franchisee gets a brief five-year overview of the biographical and professional information for the franchisor and its officers, directors, and executives who are significantly involved in the franchise program.

Item 3: Litigation

In addition to providing a ten-year history of certain litigation that has been filed against the franchisor, the FDD includes a listing of cases that the franchisor has filed in the past year against its franchisees.



TIP

This Item gives you insight into the state of the franchisor–franchisee relationship in the system. You may find a listing of cases filed by the franchisor for royalty or fee-collection issues and cases against franchisees that are not following “system standards” or, in other words, franchisees that are not following the franchisor’s rules in how they operate their units. This snapshot of cases may give you insight into the franchisor’s practice of initiating litigation, as well as the types of relationship issues that exist in the system, warranting further investigation.

Item 4: Bankruptcy

Sometimes franchisors or members of their management team or a franchisor's parents, predecessors, or affiliates have gone through a bankruptcy. This is important information because it may tell you whether the franchisor and its management team exhibit a pattern of financial problems resulting in bankruptcy.

Item 5: Initial franchise fee

Item 5 provides information about the initial fees you will pay to the franchisor or its affiliates prior to opening the business. It also tells you whether fees are uniform as to all the franchisees within the prior 12 months and discloses the range and factors that determine the amount of the fees. The initial fee is merely your fee for joining the system.

Item 6: Other fees

This Item provides a description of other required recurring fees or payments that the franchisee must make to the franchisor or its affiliates (or that the franchisor or its affiliate collects on behalf of a third party) during the course of the franchise relationship, including:

- » Royalties: The continuing payments the franchisee will make to the franchisor for the franchisee's right to use and participate in the system.
- » Contributions the franchisee will make to the system's advertising fund: See the upcoming description of Item 11 later in this chapter.
- » Requirements for the franchisee to participate in any local or regional cooperative advertising programs.
- » Additional training fees the franchisor may charge.
- » Additional fees the franchisee must pay for services or other benefits the franchisor or its affiliates provide.
- » Transfer fees the franchisee pays to the franchisor when the franchisee sells the business to a third party.
- » Audit costs the franchisee may have to pay if the franchisor audits the franchisee's books and records and finds discrepancies between them and the information the franchisee provided the franchisor.
- » Fees the franchisor charges at the end of the franchisee's current term for continuation of the relationship for another term. Note that we didn't say "for renewal of the franchise agreement." Franchisors will usually have made changes to their franchise agreements since the time the franchisee signed the original franchise agreement. In order to enter into a *successor agreement*

to continue the relationship, the franchisee usually is required to sign the then-current form of franchise agreement. The new agreement could have minor or substantial changes from the original agreement.

Item 7: Initial investment

Item 7 is in a table format. The table includes an estimate of the range of the expenditures a franchisee will make in establishing the business, which normally means “opening the doors for business.” In addition to a range of amounts that the franchisee will invest for each category of startup expenditure, the franchisor also discloses the method of payment, when the payment is due, who the payment will be made to, whether the payment is refundable, and whether it is financed. Franchisors must also list an estimate for the “additional capital” requirements of the franchisee. This is an estimate of the amount the franchisee will need to break even for the first three months of operations should there be any delays in starting or issues once operations have begun.



PLAY THIS

You can find the initial investment items that are usually included by checking out a helpful spreadsheet on this book’s companion Dummies.com website at www.dummies.com/go/franchisemanagementfd.

Item 7 typically has extensive footnotes that give prospective franchisees additional information about the initial costs included in the table. Read the notes carefully so that you have a fuller understanding of your initial investment. As with everything else, make sure you understand what the notes say.



REMEMBER

Item 7 is an estimate and your initial investment may be different. For example, if you’re entering a new market where the franchisor’s brand is not well known, you may need to spend more money on advertising than you would need if the franchisor’s brand were well known.

Item 8: Restriction on sources of products and services

For many reasons, including a desire to ensure quality and consistency, franchisors may impose restrictions on what products and services a franchisee can buy and from whom they can buy them. There may be a single source of supply, and that single source may be the franchisor or affiliate. Franchisors may also provide franchisees with specifications for certain products, services, supplies, fixtures, equipment, inventory, computer hardware or software, or other items used in the business and may make changes to their specifications. The franchisor usually retains the right to approve or revoke approval of a supplier. Item 8 will disclose these restrictions on sources of supply.

Franchisors frequently receive rebates based on the purchases that franchisees are required to make from the franchisor or through a supplier arrangement. Item 8

will also discuss what percentage any such rebate or mark-up income represents of the franchisor's total income.

It is important that you inquire about the pricing of the products and services subject to any mandatory purchasing requirement to confirm that the prices are reasonable compared to other suppliers of such products and services. Prior to making your franchise decision, you need to understand the franchisor's product and service restrictions.

Item 9: Franchisee's obligations

Item 9 provides a reference table that indicates where in the franchise agreement franchisees can find certain obligations they must perform. Although the chart doesn't discuss details, the list informs the prospective franchisee of the obligations and where to find them elsewhere in the FDD and the franchise agreement.

Some of the obligations listed may include the following:

- » Site selection, development and construction, as well as other pre-opening requirements and acquisition fees.
- » Pre-opening purchases and leases.
- » Initial and ongoing training offered and required.
- » Opening requirements including the time required to open and any pre-opening and post-opening requirements.
- » Fees the franchisee agrees to pay.
- » Requirements to comply with system standards and policies as included in the brand standards manual and elsewhere.
- » Trademarks and proprietary information provided by the franchisor.
- » Restrictions on products and services to be offered by the franchisee.
- » Warranty and customer service requirements.
- » Territorial development and sales quotas the franchisee must meet.
- » Ongoing product and service purchases.
- » Maintenance, appearance, and remodeling requirements.
- » Insurance requirements.
- » Advertising requirements.
- » Indemnification, defining the franchisor's and franchisee's rights or obligations to compensate or seek compensation for losses, damages, or injury sustained due to the actions of a third party.

- » Requirements for franchisee to participate in the operation, management, and staffing of the business.
- » Records franchisees must maintain and reports they are required to file with the franchisor.
- » Inspection and audit rights of the franchisor.
- » Transfer rights and the requirements for obtaining a successor franchise rights.
- » Post-termination rights and obligations including the right of the franchisor to purchase the franchisee's business, assets, or assume leases.
- » Noncompetition covenants during and after the term of the franchise limiting the franchisee's ability to go into similar, but unaffiliated businesses.
- » Methods used to resolve disputes.
- » Other obligations the franchisee may have.

Item 10: Financing available

Some franchise systems provide direct and/or indirect financing assistance to franchisees and Item 10 describes the terms and conditions of any financing arrangements offered. Financing for things like fees, equipment, purchasing terms, and other startup cost will be included, as well as any leasing programs and loan arrangements the franchisor is making directly or indirectly. Also included will be any financing documents, loan agreements and promissory notes that franchisees will sign if they accept the franchisor's financing assistance.

Item 11: Franchisor's obligations

While the payment of any initial franchise fee or continuing royalty is paid to enter and remain in the franchise system, every franchisor provides support and services to franchisees. These will differ from one franchisor to the next and you need to clearly understand what you will receive.

- » The pre-opening and post opening obligations.
- » The criteria and methods used to select the sites and the typical length of time between signing the franchise agreement and opening the business.
- » Training programs including duration, outline, instructor experience, fees and costs for mandatory, refresher, and additional training.
- » Advertising program, including creation, use of funds, franchisee advertising council and cooperatives, whether different franchisees contribute at different rates, and when contributions or expenditures can be modified.

- » POS and IT used, required maintenance, upgrade obligations, and franchisor's right to access information.
- » Table of contents for the brand standards manual. Alternatively, although rare, the franchisor may elect to allow the prospective franchisee to read the manual before investing in the franchise (usually subject to a confidentiality agreement).

Item 12: Territory

Although not every franchisor provides franchisees with an exclusive or protected territory, when they do the actual territory, rights and restrictions are discussed in Item 12, such as descriptions of the following:

- » The territory rights granted, whether they can be modified, and whether the territory is protected for only a period of time.
- » Any right to maintain or establish additional franchise or company-owned locations in the territory.
- » Whether maintaining territorial exclusivity is conditioned on achieving certain sales volumes or other performance criteria.
- » The franchisor's rights to sales in territory through the Internet, catalogs, telemarketing, or other similar channels of distribution or marketing.
- » The franchisor's right to operate a competing brand in territory.
- » The methods used to resolve conflicts concerning the territory.

Item 13: Trademarks

Information about the franchisor's trademarks, service marks, and trade names licensed to franchisees and any litigation or any pending applications filed by the franchisor for trademarks and service marks is in Item 13.

Item 14: Patents, copyrights, and proprietary information

Item 14 sets forth information concerning any current or applications filed for patents or copyrights and how they may be used by the franchisee.

Item 15: Obligations to participate in the actual operation of the franchise business

The obligation of the franchisee to devote their full time to the operation of the business or allowance for absentee ownership, or management by a manager trained by the franchisor is described in Item 15.

Item 16: Restrictions on what the franchisee may sell

Item 16 contains restrictions on the products and services that the franchisee may offer customers.

Item 17: Renewal, termination, transfers, and dispute resolution

Item 17 has information concerning the terms of the franchise agreement, including:

- » The length of the initial term and the number and duration of successor terms (if any), the requirements and conditions to enter into successor agreements, the right of the franchisor not to offer successor terms, and the type of successor agreement to be provided.
- » Termination rights and available cure periods.
- » Obligations after termination, nonrenewal, or expiration.
- » Franchisor and/or franchisee rights to transfer or assign the franchise agreement or business.
- » Franchisor's right to purchase the franchisee's business.
- » In-term and post-term restrictions on competition.
- » Ways the franchise agreement can be modified and methods for resolving disputes including litigation, arbitration, and mediation.
- » What state's or country's law governs the contract.

Item 18: Public figures

If the franchisor uses any public figure (celebrity or other public person) to endorse or recommend the purchase of the franchise or the public figure is used in the franchise system's name or symbol, the franchisor needs to disclose the amount the person is paid, the extent to which the public figure is involved in the actual management of the franchise system, and the public figure's total investment in the franchisor.

Item 19: Financial performance representation

The FTC Rule has established a workable and beneficial tool for franchisors to share financial performance information with prospective franchisees. Franchisors may, but aren't required to, provide Financial Performance Representations (FPRs), as Item 19 is the only voluntary disclosure item contained in the FDD.

With limited exceptions, when a franchisor includes an FPR, the information may only be provided within Item 19 and must follow FTC Rule requirements. Franchisors may present their FPR based on system-wide data, and there is no requirement that franchisors include subsets of data that share common characteristics. Information disclosed must have a reasonable and factual basis.

The FTC has not established rules for the information that a franchisor must include in constructing a FPR, how it formats it, or how it constructs the presentation. FPRs vary widely, even within the same industry subset. FPRs

- » May be presented in text, charts or graphs.
- » May be drawn from franchisee, company, or affiliate-owned locations.
- » May be based on historic or projected information (although normally the financial information is provided in the form of historical performance data, and forecasts and projections are rarely used).
- » May be limited to gross sales on a system-wide basis and may include additional information including operating costs, statistical information, and so on.
- » May be segmented by categories included but not limited to type, size, and age of locations, and so on.

The FTC Rule provides important tools for prospective franchisees to understand local variations. If they desire, prospective franchisees may request the underlying data used by the franchisor in constructing the FPR and may request from the franchisor a supplemental disclosure based on specific criteria. The franchisor, however, is not required to prepare a supplemental disclosure, and when it chooses not to, the franchisee may elect not to invest.

The franchisor may also provide cost information outside of Item 19, as long as the information is not designed to tie back to overall sales revenues. For example, even if a franchisor does not provide a financial performance representation in the FDD, the franchisor may tell you how much it will cost to purchase a particular product from an approved supplier. The franchisor may also provide financial performance information that relates only to a subset of units. For example, you may find performance data that relates to units that have been recently remodeled, that are reporting sales under a new POS system, or that have drive-throughs; and for units the franchisor owns that it is offering for sale, it may provide performance information about the operating units available for sale.



WARNING

New FPR guidelines are expected in late 2017, effective in 2018. Under these, a franchisor's ability to disclose data related to unit financial performance of company-owned units and on costs of operation will be affected. The ability of a franchisor to disclose only company-owned unit information will differ depending on whether the franchisor also has franchised units that have been open for a

full year or full season as of the franchisor's fiscal year end, and whether the disclosure relates to gross sales, gross profit, or net profit. Subset information will be available only for franchisors with more than ten units. Cost or expense data may not be separately provided by a franchisor that discloses gross sales alone, whether based on company-owned or franchised units, if a prospect could readily calculate average net profits from such information. For more information, visit this book's companion website, (www.dummies.com/go/franchisemanagementfd).

Item 20: List of franchise units

Information regarding the locations operated in the system is provided in Item 20, which includes the following:

- » A summary of system-wide growth and franchisee-to-franchisee transfers by state.
- » The number of franchises and company-owned locations by state.
- » The names, addresses, and telephone numbers of current franchisees and those who have left the system during the past year.
- » The estimated number of franchises to be sold in the next year.
- » The number of franchises transferred, canceled, or terminated.
- » The number of franchises that have not been renewed by the franchisor or that have been reacquired by the franchisor.
- » The number of franchises that are known to have ceased operation.
- » Any confidentiality agreements signed by franchisees within the past three years that would prohibit them from discussing their experience with prospective franchisees.
- » Contact information for any independent franchisee association that has requested inclusion in the FDD.

Item 21: Financial statements

Franchisors are required to include financial statements for the past three years or for a shorter period if the franchisor has not been in business for three years, prepared in accordance with generally accepted accounting principles (GAAP). For franchisors that have not franchised in the past, a phase-in of audited financial statements over a three-year period is permitted. Foreign franchisors may submit financial statements in a format permitted by the SEC if they are prepared according to a comprehensive body of accounting principles.

If a franchisor's parent company performs post-sale obligations for the franchisor or guarantees the franchisor's performance if the franchisor is providing the

consolidated financial statements of its parent company, the parent company's financials must be in the FDD with a copy of the guarantee of performance.

In addition, a franchisor may substitute the financial statements of its affiliate for its own financial statements if the affiliate's financial statements satisfy the requirements described earlier and the affiliate absolutely and unconditionally guarantees to assume the duties of the franchisor under the franchise agreement.

Item 22: Contracts

A list of agreements franchisees will be required to sign. This would generally include area development agreements, franchise agreements, confidentiality agreements, guarantees, subleases, software licenses, and so forth. The agreements are attached as exhibits to the FDD.

Item 23: Receipt

Two copies of a receipt form are provided for the franchisee's signature. In addition, the FTC requires franchisors to identify the franchise sellers (including internal personnel and outside brokers) by name, address, and telephone number.

Calling out a few key items

We think a few items require additional focus and attention:

» **Item 7—The franchisee's initial investment:** The information provided contains averages and estimates, and costs may vary for franchisees for a number of reasons, including the specific market.

During their due diligence, prospective franchisees should call existing and former franchisees to get a sense of the investment required, including working capital until they can expect to become profitable or have a positive cash flow, and the income they can expect to draw from the business to support themselves and their families. Calling franchisees that have been in the system for a year or two will provide the most current information.

» **Item 8—Products and services purchasing requirements:** Generally speaking, it is unlikely that a franchisor will approve alternative suppliers, particularly where the franchisor receives rebates in connection with franchisees' purchases of goods or services, where they want to limit the number of suppliers to the system, and especially for proprietary and trademarked items. Franchisees should consider the impact sourcing restrictions may have on the performance of their business compared to industry norms. The existence of a purchase cooperative in a franchise system is positive because the franchisees have a voice in product and supplier selection.

- » **Item 11—The franchisor’s obligations:** It is important to understand the support services that the franchisor is required to provide, including in the areas of initial and continuing support (training, site selection and development, marketing, headquarters and field support and the associated costs). Review the technology requirements, including the POS and IT systems. And understand the breadth of discretion that the franchisor has in using advertising funds.

Although you may receive additional support, the franchisor is only obligated to provide to you those support services included in the franchise agreement. If the franchise seller or broker promises additional support and these items are not included in the written franchise agreement, and they are important to you, you and your attorney will want to ensure that the franchise agreement is amended to include those promises.

- » **Item 17—Renewal, termination, transfers, and dispute resolution:** The importance of this item may only be germane at the end of the relationship or when conflict arises, but the terms vary between franchise systems, and it is essential that you understand these rights and obligations before you sign any franchise agreement.

Included in this item are severability, mergers, amendments, restrictions on the right to transfer (or sell) the franchise, and the in-term and post-term non-compete provisions.

- » **Item 20—The number of units open, closed, transferred, and franchisee contact information:** In addition to contact information for existing franchisees and those who have left the system in the past year, Item 20 provides important information on the number of units in the system, those the franchisor intends to open, how many units the franchisor has taken back and resold, and how many units have been transferred between franchisees.

An area to consider, in addition to the number of locations that have closed, is whether a high number of units have been acquired and then resold by the franchisor. This could indicate churning by the franchisor — meaning the franchisor may have acquired failed locations from franchisees and then repeatedly remarketed them to other franchisees.

The contact information allows you to speak with current and former franchisees. These are the people with whom you want to verify the information provided by the franchisor, speak about the franchise opportunity, and include in your evaluation of whether or not to invest in the franchise system. Some current and former franchisees may be unwilling to speak to you because they’re busy working or simply do not want to participate, but you should continue to call franchisees until you have the information you require to make your decision.

- » **Item 21—Franchisor’s financial statements:** If your personal balance sheet and finances looks better than the franchisor’s, what does that tell you about

your risk? Your franchisor will need the resources to meet its commitments to you. Item 21 gives you an idea of whether the franchisor can do just that.

- » **Item 22—Agreements a franchisee will be required to sign:** Make sure that all the agreements listed are attached to the FDD — and read every one of them. You are entitled to have these agreements in final form at least seven days prior to your signing the franchise agreement.

How much can I make?

Prospective franchisees want to know how much money they will make if they invest in a franchise, and who better to tell them than the franchisor? Although prior to the recession that began in 2007 only 25–30 percent of franchisors provided a financial performance representation (FPR or *earnings claim* as it used to be called), in the past few years, the number of franchisors providing an FPR has grown substantially and approximately half of all franchisors do so today.

Providing a financial performance representation is the only voluntary disclosure, and there are a number of very good reasons why some franchisors don't include an FPR in their disclosures. What should a franchisee do if the franchisor doesn't provide one?

- » Speak to the franchisees that are in the system and those that recently left. After all, current franchisees have the most accurate information on how well their locations are performing and how well the franchisor is meeting its obligations. Former franchisees can explain to you why they left the system and how well the franchisor treated them as they left — an important indication of how the franchisor manages the franchise relationship.
- » If the franchisor is a public company, review the reports it makes to shareholders as required by the SEC. These reports contain information that is not required by the FTC but that is required by the SEC.
- » Search for information on the Internet. Even though a franchisor may not be providing a financial performance representation to you, information about the company may be in articles you find on the Web. You will also be able to gather information about the competitors of the franchisor and about the franchisor's industry.
- » The FDD contains a fountain of information that, when used in conjunction with the information you develop from other sources, can be useful in developing your financial projections.
- » Examine the franchisor's financial statements contained in the FDD for information on company-owned unit performance.

- » Look at the information in Items 5 and 6, the initial and continuing fees, to see whether the franchisor has included any formulas that may be useful to you.
- » Examine Item 7, the initial investment, and the notes that follow the investment chart. Besides telling you the approximate size and type of location of the franchise (from which you can determine what your local rent will be), it often gives you information on the amount and type of staff you will need, the frequency with which the inventory of locations is sold and replaced (inventory turns), and how the franchisor calculated the disclosed estimate of working capital.
- » Item 8 has information regarding the required purchases and the percentage of a franchisee's initial and continuing operating expenses they represent.
- » The franchisor can provide you with unit cost information so long as it doesn't link that information to unit sales. Cost information alone is not considered a financial performance representation, and franchisors don't need to include an FPR in order to provide this information to you.
- » If the franchisor has locations it is offering for sale to franchisees, and those locations are in markets you may be interested in, it can share with you information on the historic performance of those locations. Although you may have your eye on starting a new location, you may find a great opportunity to buy an existing one. But a franchisor won't show you information on locations you are not actually interested in purchasing.



WARNING

If the franchise seller or broker provides you with information on unit sales even when the franchisor does not include that information in their FDD, you should be wary. Don't rely on that type of information in making your investment decision and consider notifying the federal or state regulators.

Additional information available when an FPR is provided

A franchisor that has made a financial performance representation is allowed to provide you with additional information:

- » **A supplemental FPR that is different from the one in the FDD:** You can request that a franchisor provide you with information about a particular location, market conditions, or other circumstances that may highlight certain aspects of unit operations not specifically addressed in Item 19. The information must be in writing, must explain why and how it departs from the information contained in the FDD, and must be prepared in accordance with the FTC Rule. Although the franchisor isn't required to prepare a supplemental disclosure, it doesn't hurt to ask for one when you have questions. After all, if

it doesn't provide one to you, you, don't have to invest in that franchise opportunity.

- » **The underlying backup:** The FTC Rule requires a franchisor to provide you with the information and assumptions it used in developing the FPR. This information can be useful in answering questions that may not be contained in Item 19 and may be useful in localizing the information if required.

Understanding a franchise agreement

The FDD describes the relationship between the franchisor and the franchisee, but the *franchise agreement* — the written contract that is an exhibit to the FDD — governs the relationship between you and the franchisor. The language in the franchise agreement is what you will live with.



WARNING

After reading the FDD, prospective franchisees often believe that they understand the relationship, so they just scan the franchise agreement. This is a mistake. Review the franchise agreement thoroughly and discuss it with your franchise attorney. An attorney who is inexperienced in the nuances of franchise law may be unprepared to help you understand the franchise agreement so please consult the “Lawyers” section, later in this chapter, where we discuss how to locate a qualified franchise attorney.

The franchisor's verbal promises

Though we wish it were not true, franchisor's sales agents and brokers may make promises to you about the support you will receive or other promises not included in the franchise agreement. If those statements and promises affect your decision to invest in the franchise, you will need to ensure that they are included in the franchise agreement. Unless they are, those statements and promises will not be part of your legal relationship with the franchisor.

Finding professional advisors

Finding professional advisors to assist you in evaluating a franchise opportunity may take some research on your part. Perhaps you have a good lawyer who handles your current business and private dealings and a Certified Public Accountant (CPA) who works with you on your income tax preparation. If so, you have a good starting point because they may be able to refer you to qualified franchise professionals. But if not, don't worry. Connecting with qualified help isn't difficult.

Lawyers

Franchise law is a specialty and even an experienced general business lawyer may not have the experience to provide you with the assistance you will need. The franchise attorney you select needs to have years of substantial experience in the regulatory, relationship, and practical realities of franchising. The reason is that attorneys who don't routinely practice in franchising won't fully understand franchise laws or standard practices in franchising. Based on their general legal background they likely will review the franchise agreements as they would a lease, thinking that they can make many and substantial changes to the provisions contained in the agreement. Experienced franchise lawyers understand why certain terms are in the franchise agreement and recognize when others are unusual. As a result, their comments tend to be on the important issues and on those issues that have the best chance of being changed during negotiations.

An experienced franchise lawyer will also understand what to look for in the FDD and will understand how to assist you in conducting your investigation of the franchise opportunity. To find an experienced franchise attorney, use the following resources:

- » **Your personal lawyer:** They may be able to refer you to a partner or an associate or can get you recommendations from their professional colleagues.
- » **Local and American Bar Association:** You can contact the local bar association for information on franchise lawyers. You can also go directly to the source: the American Bar Association's Forum on Franchising at www.americanbar.org/groups/franchising.html.
- » **The International Franchise Association:** Included in the membership of the IFA are law firms that specialize in franchise law both in the United States and internationally. These attorneys are members of the IFA's Supplier Forum. Although some of the firms listed represent only franchisors, it usually can refer you to competent lawyers experienced in representing franchisees: www.franchise.org/SUPPLIER/ATTORNEYS. Full disclosure: Your authors, Michael Seid and Joyce Mazero, are each past chairpersons of the IFA's Supplier Forum.
- » **This book:** You may try to get a referral from one of the authors by e-mailing Joyce Mazero at jmazero@gardere.com or Michael Seid at mseid@msaworldwide.com. We generally can steer you to a qualified franchise lawyer who can assist you.
- » **The Franchise Attorney Directory published online by Franchise Update:** You can find it at www.franchise-update.com.
- » **Other franchisees:** Don't be afraid to ask for references.

Consider your franchise lawyer to be a member of your business team and someone you will want to work with in the years to come. For now, though, your attorney will guide you through the FDD and franchise agreement and advise you on the overall desirability of the franchise offering. Expect your lawyer to review the franchise agreement and flag any items or issues that could be concerns. Your lawyer is your frontline defense against signing up for a franchise relationship that may not be in your best interest. With an investment the size and importance of a franchise, having an attorney working with you will, in the long term, be the cheapest and most effective investment you will likely ever make.

Financial and business advisors

For crunching numbers in an unemotional way, who could be better than a professional financial advisor? We're talking about a banker, CPA, or chartered accountant (CA); someone you trust and are comfortable sharing your financial information with. You can get directories of qualified CPAs or CAs from their local associations. You can see a listing of accountants who work within the franchise industry at www.franchise.org/supplier-additional-results?field_supplier_category_tid=2441&title=&isAdditional=1.

Other professionals who can provide you with assistance are franchise consultants. Many franchise brokers call themselves *consultants* today. Their role is to sell you a franchise from one of their clients and they are not a good source of information for you to rely upon in evaluating a franchisor. Although most franchise consultants work primarily with franchisors, several can be of assistance to franchisees. You can locate franchise consultants who are members of the IFA's Supplier Forum at www.franchise.org/supplier-search?field_supplier_category_tid=5416&title=.

Negotiating with a Franchisor

After you have digested the FDD, you may think the next step is haggling with the franchisor. After all, haggling—or negotiating—is the business way, right? In most situations, we would agree. But *striking a bargain* is not a phrase in the vocabulary of most franchisors.

Franchising's strength is its consistency. It is what both you and your future customers will depend on. If a franchisor is willing to negotiate substantial changes with you, likely it has done so with others. That's not necessarily a good thing. But there are some areas that you may be able to negotiate which will have little effect on the system's consistency and can provide you with some significant benefits:

- » Changing the size of your protected territory or possibly granting you a protected or exclusive territory if the franchisor doesn't typically include one.
- » Additional grand-opening support.
- » Additional training for you and your staff.
- » Extra field support.
- » Elimination of transfer fees should you want to ever sell your franchise.
- » Payment terms for the franchise fee.
- » Extended *cure periods* should you ever need to cure a default in your operation of your franchise. This item is important, because if you don't cure a default in a timely fashion, you could lose your business.
- » A change in your startup date, giving you more time to find and build out your location.
- » The formula for calculating the franchisor's purchase price for your business on termination.
- » Lower fees for *conversion franchisees* (independent operators converting over to the franchisor's system and brand): Conversion franchisees may be able to negotiate lower fees, or a longer time to liquidate existing inventory, switch to the franchisor's computer system, or make other system modifications.
- » Right of first refusal: A franchisor may be willing to give up or modify any right of first refusal it may have if you try to sell your franchise before the term of the agreement expires. A *right of first refusal* refers to a franchisor's right to match a bona fide offer you received from someone to purchase your business.
- » Guarantees and limited liability: Although you may form a corporation to own the franchise rights for tax or liability purposes, the franchisor is relying on you personally to meet the commitments contained in the franchise agreement. One of the documents you will be asked to sign will probably be a personal guarantee for performance under the franchise agreements. On occasion, if you are well capitalized or have other collateral, a franchisor may be willing to waive the requirement that you personally guarantee the agreement, or the franchisor may be willing to limit your liability under the guarantee.

2

Buying a Franchise

IN THIS PART . . .

Explore whether to buy a particular franchise, how to research franchises, and if you should buy an established franchise or open a new location.

Take a good, hard look at your current finances and figure out how to afford to buy a franchise.

IN THIS CHAPTER

- » Deciding whether to buy a particular franchise
- » Considering the services of a franchise broker
- » Locating helpful information about available franchises
- » Considering whether to buy an established franchise or open a new location

Chapter 5

Researching Franchise Opportunities

Becoming a franchisee of a solid, reliable franchise system removes much of the guesswork of running a business. It can also permit a franchisee to avoid most of the mistakes that independent startup businesses make. That's part of what you are investing in when you join a mature franchise system: a proven system of operation with the kinks already worked out.

But which franchise system should you invest in? We can provide some tools, advise on the process, and hopefully steer you away from some of the mistakes and dead ends others have suffered. However, your research and due diligence is the single most important activity you can undertake in making your franchise investment decision, and you are the only one who can do it for you. Any prospective franchisee must put in the time to get the information, assess it, and reassess it to make an informed decision. Without adequate information, you may end up making the most expensive decision of your life.

In this chapter, you can stop kicking the tires and put yourself behind a franchise “wheel” or two. But don't get too excited yet. Franchisees fail, but many franchisees could have avoided failure if they had conducted more thorough research at the front end of the franchise selection process. Take your time — don't cut

corners. Sure, saving money is important, but sometimes a prospective franchisee needs to spend money to ensure that the right decision gets made. A small investment in getting the facts right could save a franchisee the pain and expense that comes from making the wrong choice and possibly losing it all.

Information is important. This chapter will help you in obtaining information that will help you conduct good, old-fashioned research on a particular franchise. *Research* means getting past the sales hype and investigating the systems, manuals, training programs, headquarters and field support, advertising, and financials. You should also talk to other franchisees in the system and those who have left the system to confirm their views of the franchisor.

Digging Up the Good Information

We have found that the best way to gather information is to make lists of questions, write down answers, and set up a method for cross-referencing and cross-checking facts throughout the research process. Ask detailed follow-up questions. For example, assume the franchisor says it provides three weeks of training. “Gee,” you say, “that is a lot.” However, unless you find out what topics are included in the training curriculum and who is conducting the training, you may be surprised to find out you will simply be working the service counter at the franchisor’s company-owned location for 21 days. Or perhaps the franchisor says it has fully qualified field staff assigned to work with franchisees. Unless you ask, you may be surprised to find out that your “field staff” consists of one new hire who will visit only twice a year — possibly only by telephone.



REMEMBER

For each franchise system considered, write down the names of the people you talk with and their roles in the operation of the franchise. Jot down the information they give you and their comments so that you can see more clearly a realistic picture of the business.



PLAY THIS

Among the online materials (www.dummies.com/go/franchisemanagementfd), we provide a “Making the Franchise Decision” workbook you can use in making your franchise decision. This workbook is a simple tool written by co-author Michael Seid to guide you in identifying and responding to some of the key questions and issues you will need to evaluate, and to help you keep track of your information. If you’ve ever bought a house, you may remember that by the third house you saw, you could not remember which house had the big kitchen and which needed the new roof. Selecting a franchise is similar to that experience. The workbook helps remind you which franchise system was the one with the great training program and operating system and which was the one with the 30-page generic operations manual.

So where is all this research and information? Fortunately, you can choose among many different resources to get the skinny on franchising. We suggest that you take advantage of every resource you can find. The following sections discuss some of the best resources.

The Internet is the place to start

The Internet provides a showcase for franchise companies and is, as you might have guessed, a very useful way to find basic information. Most franchisors have their own websites and list their web addresses in their advertisements, franchise brochures, and, if they are members of the International Franchise Association (IFA), on the IFA's web page. Many franchisors also are included in various online franchise directories. The online directories feature basic information, including company history, total investment, liquid capital needed to invest, markets they are currently developing, and descriptions of the business. Some directories offer an analysis of particular industries and organize franchisors for easy navigation and comparison.



PLAY THIS

You can also find information about franchise opportunities on lead-generation and broker sites used by many franchisors. To give you a head start, we include a list of franchise-opportunity websites on this book's companion website (www.dummies.com/go/franchisemanagementfd).



REMEMBER

The broker sites are set up to sell you a franchise and to earn a sales commission. You are best advised to use that information as a starting point in your research, but always verify it with the other information you find during your research.

Of all the franchise-focused websites, the IFA's site (www.franchise.org) likely offers the most franchise-only information in one location. Each of the more than 1,500 companies listed is a member of the IFA and subscribes to the IFA's Code of Ethics (<http://franchise.org/mission-statement/vision/code-of-ethics>) and the IFA's Statement of Guiding Principles (<http://emarket.franchise.org/StatementGuidingPrinciples.pdf>). And, you can contact the companies directly through www.franchise.org. This site also includes hundreds of free articles, including the FTC's "A Consumer's Guide to Buying a Franchise" (<https://www.ftc.gov/tips-advice/business-center/guidance/consumers-guide-buying-franchise>). You can browse the IFA's supplier directory to find a franchise consultant, attorney, or any other business partner to assist in your research.



PLAY THIS

You can use the links provided on the book's companion website (www.dummies.com/go/franchisemanagementfd) to communicate with the franchise sales department for more specific questions. Many of these online directories allow you to complete a simple online application that can speed up the process of getting additional information from franchisors.

Print directories

Several different franchise directories list many of the franchise companies currently offering franchises. These guides are among the best places to begin your examination because they give you a snapshot of the information on each company listed:

- » **Franchise Opportunities Guide:** Published by IFA, this guide lists the trade association's member companies, franchise lawyers, consultants, and other suppliers, as well as descriptive sections on franchise statistics, other publications, and educational affiliates. In addition, the publication contains helpful articles written by professionals in the industry. This guide is a particularly good source of information because the members of the IFA include most of the strongest franchisors. You can order the guide by contacting the IFA through its website at www.franchise.org, and much of the information is also available online on that site.
- » **Franchise Update Media:** This magazine publishing group prints a variety of publications including *Multi-Unit Franchisee* magazine and *Franchise UPDATE* magazine. For franchisors, franchise attorneys, and franchise consultants, Franchise Update's publications are must-reads. Contact Franchise Update directly for pricing and ordering information by visiting www.franchising.com/about/.

There are other directories that you will find on this book's companion website. But be aware that just because a franchisor is included in one of the directories doesn't mean that the information is complete or accurate. Many of the directories do not independently verify the information that a franchisor provides. Directories are a starting place for your research — a place to get basic information, such as who is offering franchises today and what industries may interest you. Later in this chapter we discuss how to fine-tune the information so that you get a more accurate picture before you invest.

Publications to understand franchising

A number of magazines and newspapers regularly publish franchising-related sections that contain articles and advertising on franchising:

- » *Franchising World* (www.franchisingworld.com)
- » *Entrepreneur* (www.entrepreneur.com)
- » *Franchise Times* (www.franchisetimes.com)
- » *Franchise UPDATE* (www.franchise-update.com)
- » *Inc.* (www.inc.com)

- » *Nation's Restaurant News* (www.nrn.com)
- » *The New York Times* (www.nytimes.com)
- » *USA Today* (www.usatoday.com)
- » *The Wall Street Journal* (www.wsj.com)

Attending trade shows and expositions

Trade shows and expositions are opportunities to meet face-to-face with representatives of many franchise companies at one time.

The IFA sponsors the International Franchise Expos in the United States, which are a production of MFV Expositions. MFV also has several international shows. The MFV shows are gatherings of franchise companies actively seeking new franchisees. Although the months in which each is held may change, usually the three big franchise shows in the United States are as follows:

- » **Franchise Expo South:** January
- » **International Franchise Expo, New York City:** June
- » **Franchise Expo West:** November

Some of MFV's international franchise shows include the following:

- » **The Franchise Show, London:** February
- » **Féria International de Franquicias, Mexico City:** March
- » **Franquicias Expo, Guadalajara:** June
- » **The Franchise Show, Ireland:** September

The franchise shows are a great place to educate yourself about franchising. Some of the top professionals in the industry regularly conduct educational programs on franchising. For information on when and where the next Franchise Expo will be held, visit www.mfvexpo.com/event-calendar/. There are many other shows held internationally, and you will find a list of additional international shows on this book's companion website.

At trade shows, franchisors usually offer an inside look into their business on the exposition floor. Franchisees can ask company representatives questions and, if interested, provide some information about themselves as a step toward further discussions.

Attending a trade shows can be entertaining and educational. Most franchisors will give you their brochure and follow up later by telephone or in writing. At the shows, some franchisors even hold seminars (often called *discovery days*) on their franchises and may give out their franchise disclosure document (FDD), which contains information about the franchisor, its system, and franchise offerings.

Don't be surprised if a franchisor asks you to sign a receipt for the FDD given to you. Not only do franchisors try to keep track of whom they give their disclosure document to so they can contact those prospective franchisees later, but franchisors are required to keep track of when they deliver a FDD under the franchise rules.

Franchisors like trade shows because the shows give them a chance to strut their stuff as well as do some on-site prequalification of interested parties. They may ask you as many questions as you ask them. Good franchisors want to know as much about you as quickly as possible, so no one ends up wasting time.

But don't expect to actually buy a franchise at a trade show. Franchisors must follow certain rules regarding the offer and sale of franchises, and one of those rules requires that the franchisor give you a copy of its FDD and time to review it. (See Chapter 4 for a discussion of the FDD.) The franchisor cannot legally sell you a franchise — even if you want one — at a trade show. Trade shows are simply another tool to use in your research.

Hot and trendy, but does it have any legs?

You won't find a single franchise brochure that says, "We are part of a new fad that may only last a few months." Every franchisor says that its opportunity is based on solid market demand that will continue for many years.

Take a close look at the industry you are considering. What is the track record for franchisors and their non-franchisor competitors? What does the business press say about the industry's future? What impact will technology likely have on consumer demand? Remember the days when automobiles needed a tune-up every 15,000 miles, an oil change every 3,000 miles, and a new muffler every couple years? With self-driving cars, electric vehicles, and increased complexity, new technology will likely increase the need for automotive aftermarket businesses. Technology is impacting every company — not just franchisors.

Look at the companies in the industry you are researching. Have they added new products and services or changed the way they deliver products and services to consumers, or is their location design about as old and out of date as the products and services they sell? What have the historic sales trends been? How are current sales? Are they increasing? Is the company taking advantage of the opportunities that e-commerce and search engine optimization may provide the system?

Is the franchisor you are researching focused on going international, or is it focused on supporting existing domestic franchisees? Although going international can be an impressive accomplishment for a franchise system, if the franchisor is small, the hype of international expansion can often strip resources or take the focus away from smaller, less-developed domestic franchisees. This is an issue you will want to discuss with the franchisor to ensure the resources you are counting on to support yourself will be available.

The Role, Risk, and Benefits of Brokers

Franchise brokers are individuals or companies that offer to help a potential franchisee find the right franchise. Some brokers will work with you to develop your individual profile that reflects your background, interests, lifestyle expectations, and financial qualifications. Based on that profile, the broker will refer you to franchisors that meet those expectations. Some brokers, such as FranNet (www.frannet.com), will act as a liaison in your investigation process, helping you get answers to your questions and make an informed decision. Other brokers will merely make the referral and collect the fee if you become a franchisee.

A few consulting firms, like MSA Worldwide (www.msaworldwide.com), have established franchise incubators for their emerging franchisor clients and directly handle their clients' franchise recruitment while training their clients to internalize franchise recruitment efforts.

Do brokers work for you or the franchisor?

Most franchise brokers no longer refer to themselves as *sales brokers* and instead have adopted the misnomer *consultants*. As you might imagine, using a franchise sales broker may increase the pressure on you to buy a franchise. Keep in mind that you want to invest in a franchise opportunity and that can be a lot different than being pushed into buying what is being offered to you. Most brokers do not charge the prospective franchisee a fee; instead, brokers are paid by franchisors to introduce prospects to them. Franchise brokers usually receive 40 percent to 50 percent of the initial fee paid to the franchisor, and some brokers charge a minimum fee that can even exceed a franchisor's initial franchise fee. A few franchise brokers are also paid a percentage of the continuing royalty payments made to the franchisor, and still others may earn equity in the franchisor if they sell a certain number of franchises for that franchisor. Some franchisors also pay the broker additional fees (or *spiffs*), which are additional incentive payments for that broker to steer potential franchisees in the franchisor's direction.



WARNING

Ethical and competent brokers provide a valuable service to someone looking to invest his or her life savings into a franchise. Unfortunately, some brokers may not have your best interest at heart. Regardless of the best franchise opportunity for you, some brokers will push you to purchase a franchise from one of their franchisor clients because they will not earn a commission if you buy from a franchisor that is not one of their clients. Some will push you to buy a franchise from one of their franchisor clients, even if the psychological test they give you (which they may claim is meant to find you the perfect opportunity) points you away from any of their clients. Others will simply push you to the franchisor that pays the highest commission and has a history of closing sales faster. So even if you decide to use a broker, you still need to explore franchising on your own so you are armed with information to better evaluate what the broker is telling you.



TIP

After a broker identifies a company for you, make sure you independently explore other franchises in that same industry segment. There is a list of recognized franchise brokers on this book's companion website.



PLAY THIS

Although we are aware of many franchise brokerage companies, we won't be including every franchise broker on the website because some have been involved in litigation, some have been subject to regulatory review, and others we cannot recommend because of their reputation in franchising. If you're using a broker, FranNet is a good place to start. So, make certain you completely evaluate any of the professional advisors you choose to work with. On this book's companion website, we include a list of questions for you to ask a broker you are considering.

After you have the answers to your questions, you will quickly be able to identify the brokers who are genuinely interested in helping you, rather than the brokers who are interested only in receiving a commission. Remember whether you decide to use a broker or not, any franchise investigative work is your responsibility. You must invest the time and energy to determine whether any franchise is a good fit. A good broker will help guide you, but the final decision must be yours.



TIP

You are making a life-changing decision, so don't look for shortcuts. Do the leg-work yourself. Regardless of whether you are working with a broker, you need to invest in outside expertise to advise you. The broker works for the franchisor, so make sure you hire your own professional advisor such as an accountant, an attorney, or a reputable franchise-consulting firm to help you in the process. (We cover finding professional advisors in Chapter 4.)

Deciding Whether to Buy Old or New

Suppose you have narrowed your choice to one industry, and within that industry you have further narrowed your choice to one or two franchise opportunities. One

franchise company offers franchises for new locations only. The other offers new locations but also a selection of existing franchise locations. What should you do — buy new or existing?

Sizing up an existing franchise

Franchisors often have existing company-owned locations for sale or keep a list of franchisees that are looking to sell their franchises.

Buying an existing operation from the franchisor or an existing franchisee may offer advantages over starting from scratch. Instead of evaluating a potential business, you are evaluating one that is already up and running, with a history of performance, a reputation in the community, and an existing clientele. You will be able to know what the historic profit and cash flow have been for the particular site. The restrictions on a franchisor sharing unit financial information in Item 19 do not apply to the sale of company-owned operations. You will also be able to determine what the trends are for that established location.

The site is fully developed, and you avoid the burden of looking for a location, negotiating a lease, hiring a contractor, and building and equipping the location. This can be a significant advantage in time and costs. (See Chapter 7 for a discussion about establishing a location.) The operation may have a trained staff, so you can avoid the hassle of having to immediately recruit new employees and train them before you service your first customer. On the other hand, keep in mind some of their staff may be poorly trained or, worse, may need to be replaced entirely. The bottom line is you can be in business months sooner than if you start a franchise from scratch, and your cash flow will begin sooner.

You have a lot to consider when buying an existing franchise. On this book's companion website we provide many questions for you to ask about an existing franchise for sale.

From a franchisor's perspective, a franchisee buying one of their existing company-owned locations makes sense. The franchisor may have made a strategic decision not to operate a company-owned store at that location. The franchisor may have had problems finding employees or a good manager to operate the business and may be hoping that a franchisee can do the job better operating that location. However, and this unfortunately happens, the location may be a “dog” that the franchisor took back from a failed franchisee and is looking to move away from the business quickly — we call that *churning*.

As we discussed in Chapter 4, not every franchisor provides a financial performance representation (FPR) about unit financial information to prospective franchisees before they invest in a franchise. However, even those franchisors that don't provide an FPR are permitted to provide potential franchisees with

information on specific company-owned locations available for sale. If you are interested in an existing company-owned location, make sure you get the financial information about that location.

Franchisors also benefit from franchisees selling their franchises to new franchisees:

- » If the existing franchisee is unhappy, getting a new, enthusiastic franchisee is a good swap.
- » Franchisors typically require new franchisees to sign the then-current form of franchise agreement, which allows the franchisor to alter the terms of the franchise for that location sooner than it probably would have if the franchisee had stayed and operated under the existing franchise agreement.
- » If franchises are selling quickly or at a high price, that news will get out quickly and will increase the franchisor's ability to recruit new franchisees.

Note that we left out the collection of a *transfer fee* as a benefit to the franchisor. Most franchisors charge a fee for the transfer of an existing franchise to a new operator. This fee is usually a percentage of the existing franchise fee or a set amount. Although the franchisor does not have to incur the costs of recruiting the new franchisee or reviewing a site, the franchisor still incurs the costs of evaluating, supporting, and training the new franchisee. Transferring a franchise also involves legal costs for the franchisor. If the franchisor earns any profit on the transfer fee, it is usually negligible.

Before buying an existing operation, whether operated by the franchisor or an existing franchisee, do some digging for market information. Find out why the existing business is up for sale. Did the market dry up? Is the location no longer desirable? Did the franchisee tire of the business and simply want to move on to other things? Is the franchisee retiring? Look at the store location as if you are starting fresh.



WARNING

If the business is on the decline for any reason, *buyer beware*. Don't assume that you are smarter or a better operator than the selling or prior franchisee.

Also don't assume that just because you are buying a franchise, you have a full term under the franchise agreement with multiple options for additional terms available to you. Some franchisors allow the transfer of franchises but only for the remaining term of the franchise agreement. You may be able to obtain franchise rights for an extended or new term, but the franchisor will likely require you to pay an additional fee. Other franchisors give you a full term plus options for additional terms as if you were a new franchise. You may be required to execute the then-current form of franchise agreement and pay an additional fee to the franchisor under such circumstances as well. Make sure you understand not only the

business you are buying but also the term of the franchise rights you are receiving. Obtaining a full new term of franchise is usually an advantage that may also allow the seller of the business to ask for a higher purchase price, because you will be getting an extended time to amortize your investment.

Investigating new franchise opportunities

Most new franchisees enter franchising by opening a new location. You will generally get help from the franchisor with site selection, store construction, signage, inventory, grand-opening events, training, and ongoing support during the startup phase of the business.

The franchisor's helping hand may seem to be there, but be sure to do some extra pre-purchase research to discover the quality of that helping hand.

Ever consider buying a house without seeing it first? How about getting married without meeting your future spouse? When your kid went off to college, did you just hope that the school had everything the glossy brochure told you it had, or did you get in the car, board the bus, or hop on a plane and see it firsthand?



REMEMBER

Franchising is no different. You need to see the franchisor's headquarters, meet its staff, talk to other franchisees, and evaluate the franchisor's capacity to deliver the services it is promising.

Before the franchisor invites you to visit its headquarters, it will probably have done some preliminary research on you. Most franchisors require you to complete a preliminary application that provides information on who you are, your background, your employment and education history, and your financial capabilities. Some franchisors run credit checks to verify your finances or conduct civil and criminal background and litigation checks. Good franchisors are as careful in selecting who they award franchises to as good franchisee prospects are in selecting which franchise to invest in.

Some franchisors may invite you to a one-on-one tour of their headquarters; others may invite you to a group session — called a *discovery day* — where you have the opportunity to meet with the franchisor and maybe other prospective franchisees. Whichever format you experience, this is the time to get to know the people and the organization that will be your support team. Don't be bashful about your questions. Like your grade-school teachers told you: The only stupid question is the one you don't ask.

During your discovery day, the franchisor may take you on a tour of its stores. Plan some extra time before the program begins so that, after it is over, you can go see some of the stores that are not on the tour.

Use the questions in the comprehensive “Making the Franchise Decision” workbook on this book’s companion website as a starting place for evaluating a franchisor.

When professionals in the franchise industry get together and socialize at educational and trade functions, we often talk shop. Who is doing what and when, what is working and what is not. Almost always, somewhere between the first beer and the end of the night, someone uses the phrase *passing the mirror test*, which refers to franchisors that have only two criteria for selecting their franchisees: (1) The prospect’s check clears, and (2) the prospect is breathing and can fog a mirror. Being considered a franchisor in this category is not a badge of honor. (Some franchisors don’t even meet their franchisees face-to-face until they get to training. Their only requirement is the check clearing. We won’t even think about what their standards are.)



WARNING

If a franchisor does not insist that you visit with them at their headquarters or their regional support centers, beware. If they don’t care how well you are going to do as a franchisee, how much care do you figure they took in selecting the other franchisees in the system that will be sharing the brand with you? Making the trip to the franchisor’s headquarters may be expensive, especially if you are looking at several franchisors, but it is essential.

If you are married or going to operate the franchise with a partner, bring your partner along. Partners also need to get to know the franchisor. Bringing them along shows the franchisor that you are taking the visit seriously. Most good franchisors will insist on this if your spouse is going to run the business with you.

Expect to receive a copy of the franchisor’s FDD if you don’t already have one. You should always request a copy of the franchisor’s FDD early in your discovery process. Expect to be asked to sign a receipt. Franchise rules require the franchisor to provide you a copy of its FDD at least 14 days before you sign a franchise agreement or pay money for a franchise to the franchisor.



TIP

It’s a good idea to request a copy of the franchisor’s FDD — even before you go to discovery day — and review it with a qualified franchise lawyer.

Benchmarking Franchise Offerings

Every franchisor is different, and the services that a franchisor provides to its franchisees depend on the franchisor’s philosophy, maturity, and fees.

The franchise agreement defines the services that the franchisor provides and those services are usually divided into those that the franchisor provides

pre-opening, such as initial training, and those services that continue throughout the life of the franchise, such as field staff support.

If the franchise salesperson makes a promise that you are relying on, make sure that promise is contained in the franchise agreement. If it is not, the franchisor may not need to honor it. (For more on franchise agreements, see Chapter 4.)

Knowing what to expect before you open and beyond

Before you even open the doors of your franchise, franchisors help by providing services and information to new franchisees. A franchisor may do any or all of the following:

- » Determine that you have the financial resources and other requirements to become a franchisee.
- » Register, protect, and provide the use of its registered trademarks, service marks, and, if appropriate, trade dress.
- » Provide site-selection criteria, selection assistance, site-approval visits, prototype plans, construction assistance, interior and exterior design, and layout.
- » Provide sources of demographic information and an evaluation of the market where you will be establishing your business.
- » Provide specifications and sources for equipment, fixtures, furnishings, signs, products, materials, and supplies required for the operation of your franchise.
- » Provide or license a point of sale and other system software.
- » Loan you a library of operations manuals for unit operations, multi-unit development and operations, staff training, and so on.
- » Provide training for management and training personnel (if any) prior to the opening of the business.
- » Provide train-the-trainer materials for the franchisee or their trainer to train their own staff.
- » Provide information on the required or authorized merchandise and services, which you must or may offer in your locations to the public.
- » Provide plan-o-grams that give instruction on where and how to display merchandise. Plan-o-grams also provide information on promotional displays, seasonal displays, and even the *end-caps* (merchandise displayed at the end of a row).
- » Provide information on conducting a grand-opening (market introduction) marketing and public-relations program and continuing advertising and marketing.
- » Help with coordinating store-opening activities.

Throughout the life of your franchise, you can expect your franchisor to provide some services on an ongoing basis. Here are examples of some of the services you may receive:

- » Updates, from time to time, to the confidential operations manuals.
- » National, regional, and local advertising programs and materials.
- » Establishment of a local web page for your location, linked through the franchisor's website, to provide information to the public about your business and location.
- » Intranet-based training, chat rooms, and forums. Many franchisors include their manuals and some training programs on their *intranet*, which is like an Internet newsgroup, but private to the franchise system.
- » Research and development of new products and services and system enhancements.
- » Recommended, approved, and required suppliers for equipment, products, services, and supplies.
- » A franchisee advisory council (see Chapter 10) and other methods of communication.
- » Field and headquarters support in the operations of the franchised business.
- » Continuing, advanced, or replacement training.
- » Group purchasing programs for inventory, supplies, insurance, equipment, and so on.
- » Group meetings including conventions, regional meetings, and conferences.
- » Periodic upgrades and changes to site design and décor.
- » Enforcement of system standards and protection of the trademark.

Your franchisor should have systems in place to instantly communicate data on inventory, personnel, and financial reports — such as point of sale (POS) systems and management information systems (MIS). Look for monthly newsletters and/or an intranet to transmit company news, industry information, and local market data. Some franchisors use voicemail to reach all franchisees directly.



REMEMBER

Although the franchisor provides you with services to support your business, keep in mind that the primary purpose of any continuing service is to enhance and protect the value of the franchisor's brand. So it is important that you work with the franchisor and its personnel to seek out and use the services that the franchisor provides. The support, after all, benefits both of you.

Finding out about the training program

Training is one of our favorite topics because it is one of the most important aspects of a healthy and profitable franchise relationship.



TIP

The key to running a successful business is training, training, training.

But all franchisee training is not the same. Some franchisors emphasize a strong training effort at the front end to get you rooted in the basics of the business. Other franchisors believe not only in offering a helping hand in the beginning but in standing by you in years to come. Clearly, hooking up with a franchisor that wants to stand by you for the long haul is the better choice.

Also, franchise systems vary widely in their use of technology in training. If you are considering a new or recently launched franchise, you may find use of online training to be very limited because more-sophisticated online training requires large investments by the franchisor. A hard copy of the operations manual and a new franchisee training class are commonly the only training vehicles (and may be adequate depending on other support) in a startup franchise company. Modern franchising is complex, and franchisees require updating and retraining to keep them up to speed and at the top of their game.

Tapping others' firsthand knowledge

Talk to other franchisees in the system and find out exactly how much support they received from the franchisor's home office when they first opened their stores. You are trying to eliminate any surprises down the road. Did the franchisor deliver on the promised support before, during, and after the opening? What about the basic training — was it adequate, or did the franchisees feel they needed more training before opening their doors? How was the franchisees' sales performance for the first six months of the business? For the first 18 months?

A list of franchisees is provided in Item 20 of the franchisor's FDD. (See Chapter 4 for a discussion of the FDD.) Call as many franchisees as you need to until you are satisfied that all your questions have been answered. Also call some of the former franchisees listed in the FDD. Remember that they may have left on a less-than-positive basis, so you may have to filter what they say. But if they all have the same story to tell, the phone calls will be a worthwhile investment of your time. If you are purchasing a franchise outside the United States, and even if your franchisor is not required to give you a list of franchisees in the system, ask for one.

The franchisees you call are not obligated to talk to you or give you any information. Even the ones who are willing to give you information may be too busy running their businesses to spend the time to chat. Some may have signed a non-disclosure document with their franchisor and may not be allowed to talk to you about the franchise system (this is also disclosed in Item 20 of the FDD).

When you call, ask if it is a good time to talk. If not, see if you can schedule a better time to speak on the phone or come to their locations and visit with them. They probably get calls from prospective franchisees all the time, so be honest with them about why you are calling. Not so long ago, many of them were probably making the same calls to other franchisees. If you want, give the franchisor a list of franchisees you want to call, and they can alert those franchisees that you will be reaching out to them.

Don't be bashful in the questions you ask franchisees. All they can say is no. Ask them about the required investment — especially the working capital. The franchisor will provide you with an estimate of the total initial investment in the FDD; ask franchisees how close it is to reality. Did it take three months, six months, two years, or longer to break even or begin making a profit? When were they able to take a salary from the business? We don't include every question you should ask here — we just want to get you started. The “Making the Franchise Decision” workbook on this book's companion website gives you more.



Some franchisors pay their franchisees a commission or fee when they help sell a franchise. Ask the franchisor if any of the franchisees you speak with will be getting a fee. The franchisor will generally disclose this in its FDD.

Going Back Home and Eyeing Locations

From your research and from the information you receive visiting the franchisor, you should start to get a sense of what type of location you need. If you intend to open a franchise in your hometown, you need to make sure that the appropriate real estate is available. Conduct some preliminary market research. Most franchisors have fairly sophisticated support mechanisms that will assist you later, but you need to know some things before you make the decision to become a franchisee for a particular company.

Get an idea of the traffic patterns around the sites that you feel meet your needs. Call the city zoning board and planning commissions to get a heads-up on future road developments or other significant real estate plans for the area that may end up cutting into your customer base. Check with other merchants who have a customer base similar to the franchise business you are considering, and determine whether you have the right traffic at that location. For example, if you are looking at a franchise that markets upscale women's hair care, check with other merchants who sell products to a similar clientele, such as high-end women's apparel shops. This research can give you a good indication of a site's future performance potential.

Don't sign a lease or buy a location for your franchise just yet. In all likelihood, your franchisor will have to approve it before you sign the lease.

IN THIS CHAPTER

- » Taking a look at your current finances
- » Determining what a franchise is going to cost
- » Raising the money to buy a franchise
- » Funding and social franchising

Chapter 6

Raising Capital: Wowing, Wrangling, and Winning

This chapter is where you'll begin to feel the financial reality of becoming a franchisee, because without money, the deal won't happen.

The first thing a prospective franchisee needs to consider is whether they have access to the necessary funds, what franchise opportunity will they be able to afford, and will they have enough in reserve to support themselves and their family for the first year or more while the business gets going. As with any new business, investing in a franchise requires patience before you become profitable. And you may need to be more patient than franchisees in mature markets if you are going to be a pioneer in a new area.

Hopefully we can help you begin to paint a realistic picture of whether you can afford to become a franchisee — and if you can, to understand where to find the funding. Not every new franchisee is fortunate enough to have on hand the necessary funding without seeking a loan — and even if you are so fortunate, is it really a good idea not to seek outside funding? So, sharpen your pencil, get out your Excel spreadsheet, and let's go digging for dollars.

Examining Your Current Finances

Putting pen to paper and taking a good, hard look at your finances can be sobering. But it is vital that you have enough capital available — not just for your franchise investment but also for you and your family to live on as your new business ramps up. Most franchise opportunities don't achieve positive cash flow on day one, and it's best to not plan that yours will. Therefore, don't cut corners or gloss over the realities of your financial picture as you go through this process.

Statistically, the most common reason new businesses fail is not bad product or sub-par customer service, but because *they didn't have enough money going into the investment*. One of the benefits of becoming a franchisee is that the franchisor is required to provide you with information in its franchise disclosure document (FDD) estimating how much money you will require in getting into the business — including working capital.

Ask yourself some probing questions

You won't know whether you have enough money to invest in any franchise until you start examining your finances. Ask yourself the following personal finance questions:

1. What is my credit score?
2. How much cash do I have to safely invest?
3. What are my liquid investments worth today, will they meet the franchisor's minimum requirements, and will that leave me with any reserves if needed?
4. What is the equity in my home and how much can I get from a second mortgage?
5. How much is my 401(k) worth, and am I willing to risk my retirement money?
6. Will my family or friends help with my investment?
7. Do I want to bring on a partner in my new business, and if I do, will the business I choose support more than one family?
8. Can my family live off of my spouse's income while my new business ramps up?

There are no right or wrong answers, but going through this personal finance exercise will point you in the direction of what type of franchise investment you will be able to comfortably afford. Like most of us, the first thing you discovered is that you have limits on the types of franchises you will be able to invest in. This is an important milestone as it forces you to be realistic about the franchises you may be eligible for.

Seeing what you can afford

Now you're ready to begin investigating which franchise is right for you. Using the investment parameters you've established, begin to explore the various franchise directories. Although there are several online and printed opportunities guides available to you, we recommend you begin with the Franchise Opportunities Guide available at the IFA (www.franchise.org).

Whether buying a house or a car, it's natural for many people to start playing with the numbers to convince themselves they can afford to risk more than they really can, but beware of this tendency when you invest in a franchise. A franchise investment can be a life-changing investment, and you need to be *certain* that you don't overextend yourself. Better to start your drive in the red zone than on your own 5-yard line (check out *Football For Dummies* (Wiley, 2015) if you don't know what *red zone* means).

You're likely to find many franchise opportunities you can afford because of the wide variety available. You might even look at multiple locations in some low-investment franchises to spread your risk, as some of them have an extremely good return on investment. Once you've completed your preliminary list of franchises, now is the time to go back through the directories and make up a bit for opportunities that are just a bit beyond your limits. In today's economy and with the competitive nature of franchise sales, franchisors are finding creative ways to help their franchisees become eligible for their investment.

Recruiting franchisees is very competitive, and many franchisors have created special arrangements for targeted franchisees like veterans, women, or minorities. Many also offer assistance in obtaining a loan or facilitating equipment leasing. Keep a sharp eye out for those opportunities when looking through various franchise directories, but remember, just because they offer you a special discount doesn't mean they are naturally a better or safer franchise opportunity. At this point, all you're doing is exploring what franchises you may be eligible for. Frequently a franchisor can look at your numbers and see creatively how their investment can fit within your budget.

Consider a "used" franchise

Franchisors you are considering may have opportunities that you may not be aware of, such as company- or franchisee-owned units that might be available. Frequently, the franchisor or franchisee may be motivated sellers willing to work with you by offering some self-financing or another creative arrangement. Just be certain that the existing business's cash flow will be able to support the debt service you will require.

A “used” franchise opportunity may have some advantages. You will be able to avoid much of the speculation on the business’s future performance, the business already has a location, trained staff, an existing customer base, and an historic cash flow. A used franchise may also be more attractive to bank lenders because the normal delays in starting your franchise are substantially eliminated, and it has a record of achievement to examine.

Make certain when looking at any existing business to determine what additional investment you may need to make to bring the location up to the franchise system’s current standards and also get an understanding of the capabilities of the existing staff you may be inheriting. Discuss with the franchisor whether you’ll be receiving a new franchise agreement with a full term with successor terms or whether you are going to receive only the remaining time available on the existing agreement. Be sure to work with an experienced franchise lawyer when purchasing any existing business.

“Particularly for new franchisees with limited experience in real estate development and construction, an existing franchise location can greatly reduce risk and avoid the ramp-up to profitability, which can be significant for a brand new location,” says Aziz Hashim, managing partner of NRB Capital, LLC, and past chair of the International Franchise Association (IFA). “Many new franchisees underestimate the cost of providing for their household expenses during the time while their new location becomes profitable, which subsequently results in immediate cash-flow problems.”

Determining Franchise Investment

Any new business, whether you go it alone as an independent or as a member of a franchise system, is going to require an investment. If the only benefit you received from a franchise system was an educated estimate of the costs of developing the business, sources for equipment and suppliers, and the knowledge of how much working capital you may need, that alone would make franchising worthwhile. Because they can provide you with this level of information, an experienced and mature franchise system is worth its weight in gold to a new franchisee.

Franchisors provide in their disclosure document an estimate of a franchisee’s initial investment. Though provided as a range of costs, this information can only be an estimate for any franchisee because markets and locations will be different. Franchisees should not rely on this information as their only source of data and should verify the information with franchisees that have recently opened locations, seek other information, and build their own localized model. The variations in rent, construction costs, freight, labor, and any number of factors can be significant from market to market.

What your startup costs may look like

Without the information contained in a franchisor's disclosure document, you would need to research equipment options, work with designers on décor packages, independently research which vendors to use, and so on, and franchising reduces the learning curve. Franchising succeeds because the franchisor provides a franchisee with detailed information on a variety of issues. Item 7 of the franchisor's disclosure document, provides information on a franchisee's potential initial investment.



REMEMBER

Your initial investment may vary dramatically depending on whether you own or lease real estate to operate the business. Fixed-based franchises — those that require bricks and mortar — almost always cost more than mobile type franchises you can operate from a van. Also, franchises that require Class A retail space (locations that are highly visible in high-traffic locations) will have a higher operating cost (rent) than businesses that only need a Class B (less viability and traffic) or Class C (warehouse) location.

Franchisors project a franchisee's initial investment in Item 7 based on their experience and the experience of their franchisees. These costs will need to be localized as you explore the costs in your neighborhood. When making any projection, remember that you will be relying on assumptions about events that have not yet happened and even if all your assumptions come true — and they won't — you will experience differences between the projected and actual results. Often those differences can be material. When making any projection, be prepared and expect the worst — and hope for the best.

You must carefully read and understand the pages of notes that follow the ranges of investment included by the franchisor. Your initial investment will vary, often dramatically, depending on the franchise system you select. There are franchise opportunities that require an investment of \$20,000 (or less) and many that need a \$1 million or more to get into. Franchisors and bankers will want to see that you have *liquid* (cash) capital available of around 35 percent to 50 percent of the total franchise investment (the franchise fee, working capital, plus all startup costs) because they want to make sure you have enough money to get started and pay your bills, including any principal and interest payments on your loans.



TIP

Borrowed money comes at a relatively low cost today, and because of that you may be inclined to leverage as much of your initial investment as you can. With Small Business Administration (SBA)-guaranteed loans available, leveraging is a good and workable strategy, but you need to be certain that your business can service your debt. By developing detailed projections you will be able to compare the estimated return on your cash investment for each franchise opportunity you are considering and predict whether that the business will enable you to service your debt.



PLAY THIS

The companion website (www.dummies.com/go/franchisemanagementfd) provides a detailed chart of many of the costs you will likely incur in starting your business.

Initial expenses to set up shop

You will incur many costs in the development of your franchise. Some, such as the franchise fee, you have likely thought about. Others, such as travel and living expenses while you're at training, as well as pre-opening labor, may not be so obvious. This section will highlight some of the more material costs you should anticipate.

The franchise fee

The franchise fee you pay is your price of admission to the game, but not the price to suit up and play. The franchise fee is the amount you pay the franchisor initially to become part of the system.

Internally, franchisor's generally set this fee to offset their cost of locating, screening, negotiating with, and training you. They also use it to cover the costs involved in site selection and development, promotions, grand-opening events, and ongoing support during your first months of operation. They set their fees also based on what they believe is the attractiveness of the investment opportunity and, of course, how competitive the marketplace is in attracting and securing franchisees.



TIP

Don't fall into the trap of thinking that you are paying your franchise fee in exchange for services and support. All the initial fee gets you is entrance into the club. A higher fee does not indicate more startup assistance any more than a lower fee means you will get less support. Carefully read your franchise agreement to determine what support and services your franchisor will be providing to you. Regardless of what the franchise salesperson or franchise broker tells you, if it is not written in the franchise agreement, it probably won't happen. Generally, the franchisor is not obligated to provide you with any additional services and support other than as provided in the agreement.

Franchise fees vary, depending on the franchisor. They can range from \$0 (which is very unusual) to more than \$100,000. Typical franchise fees today range between \$20,000 and \$45,000, with the average franchise fee of around \$37,500, but that's highly dependent on the industry and the franchisors in that industry group. If you're planning on opening up more than one location and will be signing a multi-unit development agreement, you can expect your initial fees for your additional locations to be less than what you needed to pay for your first location.

Each franchise system is different — even in the same industry. As with every contract, first review the agreements with an experienced franchise lawyer. (See Chapter 4 for information on how to select your advisors.)

Other costs: Building out your location

Many potential costs are included in your initial franchise investment, in addition to the initial franchise fee. In particular, make note of the following:

- » Costs for finding the right location
- » Civil and architectural drawings and professional fees
- » Contractor fees
- » Construction and leasehold improvements
- » Décor packaging and signage
- » Equipment and fixtures
- » Freight and sales tax
- » Hardware and software
- » Insurance deposits
- » Landscaping
- » Licensing and permits
- » Opening inventory
- » Rent deposits and occupancy charges
- » Security system
- » Utility deposits
- » Zoning expenses
- » Other prepayments

Training

Before you open up your business, expect your franchisor to require you and some of your key employees and management to attend training. Most franchisors take training seriously, and, depending on the complexity of the business and the philosophy of the franchisor, you can expect to spend as little as a few days and sometimes many months being trained in how to operate your new business.

Most franchisors will include the cost of providing you, your initial unit manager, and your trainer with training in the initial franchise fee. Depending on the franchisor, it may also provide training for additional management and staff. If you are a multi-unit developer and won't be managing the unit directly (someone else will be responsible for the day-to-day management of the business), your franchisor may have a shortened training program as an overview for the business owner.

Also, don't forget the salaries and benefits for your staff attending training with you. You should anticipate other costs as well, including the ones in the following sections. Although the cost of tuition for initial training is often included in the franchise fee, as mentioned, you will probably have to pay for airfare, hotel accommodations, local transportation, food, salaries, and employment benefits for yourself and any of your staff who attend training. These expenses are on top of any salary you will lose from your current job while you attend training.

Pre-opening labor

Before you even open your doors and collect dollar one, you must pay your management team and staff. Your employees will help you set up and will need to learn how to run the business before that first customer comes in.

Professional fees

In addition to your architect and the professionals you hire to help you get through zoning and local approvals, you need the services of an attorney to help you negotiate your lease and do all the other legal work required to set up a business. You also need an accountant to help you set up your books and records. And don't forget the cost of the franchise lawyer you smartly engaged to help you evaluate the franchise opportunity originally.

Working capital

Working capital is the amount of money you need to support your ongoing expenses that are not covered by your *revenue* (the money your business brings in). Depending on your business, you may need as little as two or three months or as much as two or three years of working capital. Although your franchisor will include in Item 7 an estimate of the working capital you will need, it is best that you consult with an accountant in coming up with your own estimate.



REMEMBER

When planning for your initial investment, remember that projections — especially regarding working capital — are not a guarantee of what you will actually need. Projections are educated guesses based upon the best facts available at the time. Be conservative and don't plan on the best outcome.

Do Your Homework before Holding Out Your Cup

Before you start out on any trip, you need a destination and a map telling you how to get there. Even with a GPS device, you still need to tell it where you want to go. Finding your way to a successful business really is not that different, except that you need to do your own research and plot your own course. This section helps you begin the process of creating a business plan for your franchise. Although you will receive information from the franchisor, you and your accountant still need to adapt it to your business and situation, and you will need more information than simply the FDD.

It may seem logical that, after you complete your business plan, you send it to your franchisor for them to review, edit, and comment on. Don't be surprised if your franchisor is unwilling to review your plan. Rules govern a franchisor's pre-sale activities, and one of them deals with a franchisor making financial performance representations. As strange as this may sound, if you send your business plan to the franchisor and the franchisor comments on it, it may be violating the rules in making projections regarding potential earnings for your business. Speak to your franchisor regarding its policies. After you become a franchisee, the franchisor usually will have fewer restrictions on helping you create or fine-tune your plan, but before you buy, the franchisor is restricted in what it can say and do. In creating your business plan, you and your accountant are substantially on your own.

Creating a business plan

Regardless of where you ask for money (your local bank or your Aunt Edith and Uncle Fred), anyone providing you with funds will want to know something about your business and how you plan to operate it. (And to be successful, this is something you need to plan too). In other words, they will want to see, and you need to have, a business plan.



TIP

Think of a business plan as a road map. It gives you and your lender the lay of the land, some directions, and an idea of where your business is headed. You are the mapmaker and the tour guide. You are responsible for helping your lender see the destination and how you plan to get there. Don't fake any of the information — especially the numbers. Lenders and investors hate surprises. You should too. Reasonable projections are hard enough to create and achieve without starting out with bad information.

Keep in mind that a business plan may be a pain to write, but writing one forces you to focus on setting goals and figuring out how to reach them. It also requires

you to spend the necessary time examining each assumption and detail. Take your time and give it your full attention. Don't be afraid to rewrite and then rewrite again. Indeed, the best business plan is a living document — you continually update it. It also is creative, reflects your enthusiasm, and includes solid information. And you can be optimistic, but only if your optimism is based on reality.

Among other details, a business plan defines the reasons you need financing, the way you are going to spend the money, and the method you will use to repay it. It should explain to the reader everything about your location and how you intend to operate it. It should give the reader an understanding of your expected cash flow and what you think will be your return on your investment. If you believe that your location will be better than the average location in your franchise system, let the reader know why you think so. Have facts available to support your assumptions.



TIP

Your franchisor should be able to assist you with information specific to the business — and it has already done so in the disclosure document. If you hire an attorney and/or an accountant, ask them for input, too. Many, but not all, have experience preparing business plans for franchisees and can offer valuable advice. Most experienced accountants will be able to obtain information about your type of business that the franchisor's disclosure document does not contain. Also, speaking to existing and former franchisees in the system will provide you with a wealth of data to use in building your assumptions.



REMEMBER

After you have a plan, follow it, don't file it. Update it as you learn more. A business plan should include at least the following elements:

- » **Executive summary:** This is a description of the franchise, products and services, opportunities, risks, strategies, target market, competition, competitive advantage, investment, financial overview, and projected return on investment. Keep it short. Even in a complex business, the executive summary should not be more than two pages long. Experience shows that if the introduction to your business plan is not well written, factual, exciting, and enticing, the proposed investor or lender often won't read any further and won't provide you with the funding you need.
- » **Mission statement:** A mission statement defines the culture of your business. It should describe the fundamental reasons for the company's existence and establish the scope of its activities. The mission statement is a reflection of your philosophy as it relates to such things as the franchisor and the system, profitability, professionalism, customers, employees, vendors, and your community. You should dovetail your mission statement with the mission statement of the franchisor to show that you intend to operate the business to meet the franchisor's brand promise to its consumers.

» **Overview of the business structure:** This section provides the reader with information about the business, including the date the business will begin, who you are, and whether you will be active in the business. It should also discuss something about the franchisor's management team and some history about the company. You should discuss whether the business is being acquired from a prior owner or whether it is a brand spanking new startup location. Also discuss in this section any of your outstanding accomplishments and any setbacks that you have experienced and overcome.

» **Industry analysis and background:** After the executive summary, the industry analysis and background section is the most closely read section. In order for the company to have a clear direction, you must understand the industry you're going to be in, your competition, and your position in the market. For clarity and comparison purposes, use charts where appropriate to compare your company and its products and services with those of the competition. Describe the industry in which you operate by answering the following questions:

- What is the size of the industry? The reader will want to understand how large the industry is and whether it is growing.
- Who are the major participants in the industry? In other words, who are your competitors, market leaders, franchisors, and suppliers?
- Do a few companies dominate the segment, or is the market fragmented among a lot of smaller mom-and-pop businesses?
- Is the market made up of a large number of potential customers, or do a handful account for a high proportion of sales?
- What factors are important to success in your industry?
- What do published forecasts say about the future growth and profile of the industry? How will technology impact your business?
- What legislation and environmental or business trends will affect your industry?
- What advances has the franchisor recently made and what new advances are they highlighting for the future?

» **Market analysis and strategy:** In this section, you talk about your potential customers, the size of the market, trends in the industry, the existing and emerging competition, the type of location you need, and how the franchisor wants your location to look. It tells the reader that you know about the business in which you will be operating and gives them a sense about how buttoned down the franchise system really is.

» **Description of day-to-day operations:** People are your most important asset in any business. In this section, you describe how you intend to manage

the business — by yourself or through a management team while you keep your current job. Let the reader understand your staffing plans for recruiting and paying personnel, the training programs you will be providing to your staff, and whether you'll be adapting the franchisor's training program or creating your own. This section also deals with having the proper products and supplies to offer to the public and operate the business. You should also include issues dealing with your suppliers, how they will distribute to you, and how you will deliver the product and services you will offer to your customers.

- » **Marketing plan:** Every investor, lender, or member of management is interested in how you intend to attract customers to your franchise. In this section, you describe the overall franchise system's strategy for marketing, including any neighborhood and local marketing strategies, and your specific local marketing plans. Most franchisors also will help you plan your grand-opening marketing programs. Let the reader understand how you intend to launch the business. Ramping up any business requires money and a plan. Letting the reader know that you are prepared to accelerate the growth of your new business is important. Finally, address your pricing strategy. Do you intend to offer everyday low prices, or is your strategy to offer high prices as a standard practice with perhaps low promotional pricing for sales?
- » **Management and organization structure:** Describe the day-to-day management required to operate the business; if you know who they are, include some biographical information about your managers. Describe the number and type of staff you need to recruit, as well as your compensation plans, employee benefits, and recruiting and retention plans. If you intend to work in the business, make sure to include information about yourself and the compensation you plan to take out of the business. To savvy investors, the experience and abilities of management are often the most important elements they consider when evaluating whether you and your idea will be worth the financial risk.
- » **Financing:** What is the total startup investment you require? Will the business require additional funding down the road? If so, how much and when, and what will you need the additional money for? Provide the reader with information about your profit and loss forecasts and cash-flow analysis for five years. Provide a detailed examination of the amount of sales you will need to break even and turn a profit.
- » **Implementation plan and timetable:** In the business plan, not only do you need to deal with the *whats* of everyday operation, but you also need to include a detailed description of the *hows*. If yours is an existing business, what changes do you intend to make to meet the plan? What is the cost of implementing those changes, and when do you expect to recoup those costs? If your business is a startup, define the investment, the time frame until opening, and how long before you expect to break even and get some return on your investment.

» **Appendix:** The appendix is the place to provide the reader with copies of your tax returns, articles about the company, articles about the industry, information about the community you will be serving, and any other information that will help the reader understand the business. You likely also will be asked to provide a copy of the franchisor's disclosure document and contract.



TIP

“The corporate and investment design structure of your ownership in a franchise is critical,” says Aaron Chaitovsky, CPA and franchise practice leader for Citrin-Cooperman (Citrincooperman.com). “Whether you are acquiring a used franchise or investing in a new one, the way you are structured will have a major impact on not only your tax benefits and liabilities but, congruently, your working capital as well. It is imperative that you consult with accountants and advisors well-versed in the franchise space at the earliest stages of your decision to enter into the industry.”

Creating a business plan may sound very scary, but if you truly want to go into business, doing so is a must. In fact, you should find preparing your business plan a welcome challenge. If not, perhaps you don't have the discipline to own your own business. Often, a franchisor will help you prepare your business plan by giving you a template to use. Keep in mind that the franchisor must be careful not to violate federal and state requirements that regulate its ability to make financial performance representations. (See Chapter 4 for a discussion of financial performance representations.) When seeking investors, you should also consider whether your attempt to raise money will be considered the offering of a security. A knowledgeable attorney can help in these circumstances. For more on writing business plans, see *Creating a Business Plan For Dummies* by Veechi Curtis (Wiley, 2014)

The SBA: What they want to see

The Small Business Administration (SBA) is a United States government agency with the mission to provide support to entrepreneurs and small businesses. One way it provides this support is by guaranteeing loans made by banks and credit unions to qualifying small businesses.

SBA loans are made through banks, credit unions, and other lenders who partner with the SBA. That is, the SBA doesn't make loans itself, but rather provides a government-backed guarantee on part of the loan. It has established guidelines for loans that it will guarantee. By guaranteeing that the loans these institutions make to small business will be repaid, the federal government diminishes some of the risk to financial institutions so that they are more likely to consider lending to small businesses — businesses they likely would have turned down without those guarantees.



TIP

If you are in the United States and if you qualify, an SBA-backed loan may be a way to obtain a loan not otherwise available. You stand a better chance of success with a certified SBA lender.

Recently the SBA revised its approach to franchisee financing in an attempt to streamline the Franchise Registry (www.franchiseregistry.com). The Registry is an SBA program that lists names of franchise companies whose franchisees can get a streamlined review process. Prior to the SBA's new program, effective January 2017, the SBA had established an SBA Registry where the agency conducted a review of a franchisor's franchise agreement and disclosure documents to determine whether its franchisees had sufficient independence as business owners to be eligible for an SBA-guaranteed loan.

Under the SBA's new program, franchisors and franchisees are required to sign a new SBA Standard Addendum to the franchise agreement that covers affiliation between the franchisor and franchisee. Once the SBA Standard Addendum is signed, the SBA will consider the franchisor and franchisee to be independent parties. In most situations, the SBA's goal is to no longer need to review the franchise agreement and disclosure documents. The SBA Standard Addendum cannot be modified or negotiated, and it contains the following non-exhaustive list of provisions:

- » **Change of ownership:** This provision limits the franchisor's right of first refusal when a franchisee seeks to transfer only a partial ownership interest. Franchisors cannot unreasonably withhold their consent to any transfer, and once a transfer is approved by the franchisor, the selling franchisee will not be liable for the franchise obligations of the buyer.
- » **Forced sale of assets:** Upon the termination or expiration of the franchise agreement, the franchisor may purchase the assets of the franchisee based on either an agreed-upon price or at an appraised value.
- » **Real estate:** If the franchisee owns the real estate used for the business, the franchisor won't be able to record restrictive covenants against the property or force the franchisee to sell the real estate to the franchisor upon default or termination. If restrictions are already recorded against the franchisee's real property by a franchisor, those restrictions must be removed in order for the franchisee to obtain SBA-assisted financing. But the franchisor can require the franchisee to lease the franchisor the real property for the duration of the franchise term.
- » **Employment:** The franchisor can't directly control (hire, fire, or schedule) the franchisee's employees. For temporary personnel franchises, the temporary employees will be considered to be employed by the franchisee not the franchisor. The addendum doesn't define the term *temporary employees*.

There are several other requirements under the SBA's new program, and the SBA is continuing to revise its policies. For example, six weeks after launching the new program, the SBA issued new policy guidance that offers an alternative to the SBA Standard Addendum for franchisors who, prior to the new program, had finalized an SBA Negotiated Addendum. Now franchisors may elect to use an already existing SBA Negotiated Addendum previously approved by the SBA before the new program, along with an SBA Certification form. However, the SBA Negotiated Addendum must be an addendum that was developed by the SBA and the franchisor using a 2015 or 2016 version of the franchise agreement. All other franchisors must use the SBA Standard Addendum. Accordingly, the SBA's new program is a moving target, leaving lenders and franchisors with uncertainty as to likely SBA changes to come.

Several franchisors have stated that they may be unwilling to sign the SBA Standard Addendum. You should check with any prospective franchisor about whether or not they will participate in the SBA's new program. If a franchisor is unwilling to sign the SBA Standard Addendum, you may not be able to obtain an SBA-guaranteed loan from your lender under the SBA's current policy. The SBA's new program only streamlines the process — it's not a guarantee that you will be able to borrow any money.

The SBA has an application you will be required to complete and a published list of items you will be required to submit to the bank in connection with seeking a SBA backed loan. The applications and list can be found at www.sba.gov/loans-grants/see-what-sba-offers/sba-loan-programs/general-small-business-loans-7a/7a-loan-application-checklist. Much of the information and documentation is the same that's required to provide a bank and set forth earlier in the chapter, but on SBA required forms. A summary from the web site includes the following:

1. The SBA Loan Application.
2. Personal Background and Financial Statement, including forms showing Statement of Personal History, SBA Form 912, and a Personal Financial Statement, SBA Form 413.
3. Business Financial Statements, including for an existing business a current profit and loss statement and for all businesses a detailed projected financial statement, with a one-year projection of income and finances and written explanation as to how you expect to achieve this projection.
4. Ownership and Affiliations. Include a list of names and addresses of any subsidiaries and affiliates, including concerns in which you hold a controlling interest and other concerns that may be affiliated by stock ownership, franchise, proposed merger, or otherwise with you.

5. **Business Certificate/License.** Your original business license or certificate of doing business. If your business is a corporation, stamp your corporate seal on the SBA loan application form.
6. **Loan Application History.** Include records of any loans you may have applied for in the past.
7. **Income Tax Returns.** Personal and business federal income tax returns for previous three years.
8. **Résumés** for each principal of the company.
9. **Business Overview and History,** including a brief history of the business and its challenges and an explanation of why the SBA loan is needed and how it will help the business.
10. **Business Lease.** A copy of your business lease or a note from your landlord, giving terms of proposed lease.
11. **If you are purchasing an existing business, the following information is needed:**
 - Current balance sheet and P&L (profit and loss) statement of business to be purchased
 - Previous two years federal income tax returns of the business
 - Proposed Bill of Sale including Terms of Sale
 - Asking price with schedule of inventory, machinery and equipment, furniture, and fixtures

Projecting income and cash flow

Most franchisees would rather run their businesses than spend time crunching numbers. However, bankers and investors want to see a projected income and cash-flow statement before they will invest in your business. Having well-structured projections reassures them that you have thought through the realistic cash flow and growth of your business. The numbers may not be absolutely on the mark, but they show bankers and investors that you are thinking like a person who plans to be in business for a long time.

Where do you begin? A good place to start is to understand all the costs of staying in business for the first 60 months. You want to develop a cash-flow statement by month for the first and second years, and at least by quarter for the third through fifth years. And a good source to obtain this information are the existing franchisees. Though some may be reluctant to share their financial information with you, they have the most relevant information you can use. Make certain the franchisees

you speak with are in markets similar to yours and that they are providing you information you can use as a new business. Verify your information with as many sources as possible.



TIP

Many franchisors today will provide you with annual cost information but are restricted in the information they provide with respect to costs that tie to unit sales. When the FTC made its last revisions to the FTC Rule, it adopted a way for franchisors to give you information on the costs of operating the business but restricted how a franchisor ties that information into expected unit sales. The unit cost information doesn't need to be included in the franchisor's disclosure document, but the expected or historic sales information, if it is provided, must be.



REMEMBER

The economics of selling ice cream in Fairbanks, Alaska, may be quite different from the economics of selling ice cream in Fort Lauderdale, Florida. Information about units that do match the demographics, size, and location of your franchise may be interesting, but it can also be misleading if you rely on it for projecting future results for your business. If the franchisor has prepared a financial performance representation, you can ask the franchisor for the data it used in support of the disclosure, and frequently that will allow you to localize the information. You can also request that the franchisor prepare a supplemental disclosure breaking out information on defined criteria, but again, only when an FPR was included in the FDD.

Ask some of the local franchisees what accountant they use. An accountant who is experienced in the industry and who has a proven track record is your best bet. An accountant may be a source for projecting income and expenses if they have any experience in your business. Some franchisors require you to use their accountant for a period of time after you become a franchisee, but that requirement is not typical. The reason those franchisors make that requirement is not that they are nosy — they are going to see that information in most cases anyway. They do so in order to keep you focused on the operation of your business and your customer service and not be spending time creating financial reports and tax filings.

Armed with both an annual cost figure and projected sales, you can forecast your needed cash flow. The FDD gives you the projected initial investment. If system profit and loss information is included in the franchisor's FDD, it will also tell you how well the operating locations on which the franchisor reports are doing. If your franchisor includes a financial performance representation in the information it gives to you, it should be able to provide you with some of the detailed assumptions it used in the notes to its Item 19 Financial Performance Representation. This information is important to understand.

Raising Capital

Today, there are many ways to finance your new business. Some you know well because you grew up in their home — Mom, Dad, and your brothers and sisters are all good places to look because they know you the best. Others exist as well, including angel investors and lenders. Your franchisor will be a good source of ideas and will tell you what has worked well in the system. The franchisor may even be able to introduce you to folks with whom the franchisor has established a relationship.

If you are the average prospective franchisee, you have pulled together all the financial resources at your disposal by combining your savings, the collateral in your home, bank financing, loans from family and friends, and possibly money from outside investors or lenders. Keep in mind that you can also cut your overall initial cash requirements by leasing your real estate and equipment rather than purchasing them. Most franchisors will walk you through the leasing options for their system.

Avoiding debt

Everyone aspires to avoid debt, but most people deal with it on a regular basis and it can be a very effective tool, especially when interest rates are low. But going into debt to buy a franchise is not something you should take lightly. Before you put your retirement fund on the line or refinance your home, look at a few ways to raise cash in order to minimize your debt:

- » Use money you have put aside for a future project or a second home.
- » Ask family and friends — they already know and trust you. They may want some equity in the business. Just keep in mind that family and friends are often more intrusive than professional lenders; also, you may damage relationships if the investment does not go well.
- » Consider bringing in a partner who can offer money up front and/or on a continuing basis.
- » Sell your boat, cabin, second house, scuba gear, RV, jewelry, or any other toy or collectible you don't use.



WARNING

Unless you live on the edge and like added risk, consider the following advice:

- » **Don't use your credit cards to get ready cash.** Interest rates are too high and you can run up your credit limit and get into financial difficulty too easily.

» **Don't use your 401(k), IRA, retirement funds, healthcare accounts, life insurance policies, or college funds to start up a franchise.** These accounts are for protecting your — and your children's — future.

There are a few companies in franchising, like Guidant Financial www.guidantfinancial.com/financing-solutions/401k-business-financing/, that provide advice on converting 401(k) investment into funding for franchises. Through a program called Rollover for Business Startups (ROBS) Guidant enables you to invest your retirement funds into a franchise without a penalty. While many franchisees have successfully used a 401(k) rollover plan like that provided by Guidant, given the risks involved in successfully operating any business, your authors are reluctant to advise you to use these types of investments in funding your new business.

Visiting the bank

Although interest rates are low today and startup funding is becoming more readily available, you still need to plan for your visit to the bank. We can't imagine that LeBron James would ever think of going into a game without first practicing and perfecting a few moves to guarantee a basket. That same attitude works when you approach lenders — except the ball is in their court, and your goal is to convince them to toss it to you.

Local bankers are in business just as you are, and they want to help you succeed. In order to do that, they need information about you, your plans for the future, your business, and franchising overall. Your business plan covers some of the information, but nothing is better than a personal visit to get started.

Just as franchising is based on relationships, so is banking. Establishing and nurturing an ongoing relationship with your banker is very important. That commitment means dropping in and visiting with them on a regular basis and sharing your progress as you get closer to signing your contract. In other words, your banker wants you to keep them informed. No banker likes surprises. The more you share of yourself — your business ideas, hopes, dreams, and goals — the better your banker can assess your loan application.



TIP

If you don't click with your local lender, shop around. Visit a few banks in your operating area and see which one is a good match. Make sure the bank you choose has experience with small businesses. You should also visit your local credit unions, which have emerged as some of the more flexible sources of franchisee financing.

Franchisors often establish relationships with a group of lenders who are familiar with the business and will provide funding to qualified franchisees. Franchisees can also point you to banks that financed their businesses. A banker who has already financed a successful franchisee will be more receptive to your application

and will need less education. On occasion, the franchisor may act as a guarantor of the franchisee's loans — but this is very rare. Even rarer is the franchisor that provides the loans directly.

Be smart in putting together your sales package for the banker. When you're presenting information for a loan, you're selling the bank not only on the business but on you as a businessperson. The banker wants to see that you understand what you're getting into and how you're going to pay back the loan. If you can't put together a good presentation package on your own — and it should be more than just the forms the banker gives you to fill out — work with a professional such as an accountant to complete the package.

Getting a bank's support sounds pretty simple. But few franchisees take the time to establish relationships with their bankers. They show up when they want money. Consider your banker to be part of your business team, and keep the lines of communication open.

Finding an angel investor

After you've tapped all the available sources of conventional funding — friends, family, personal savings, franchisor assistance, and SBA-guaranteed bank loans — think about finding an angel investor. No, this is not someone wearing wings. Typically, *angel investors* are individuals or groups who offer startup funds in exchange for a direct role in a new business. They are people with high net worth who want to invest in businesses they know about. Although an angel is usually an individual, angels often form groups that commit larger sums based on the recommendations of one of the group's members.

National, regional, and local angel networks exist, and each functions a bit differently from others. The networks are usually fee-driven, and you pay either to join the network or to present your plan. Depending on the network you select, you may be able to post information online about your opportunity for members to read, or you may need to provide it only upon invitation. You can find several directories of angel investors on the Internet.

An angel investor often expects a direct role in advising the new company. This counsel can be an advantage for a new franchisee because often, an angel can bring expertise to a new business that the owner cannot get elsewhere.



WARNING

Angel investors become your partners and may require you to seek their permission before you make decisions. You will probably give up some control, and you will certainly give up some of the profit if the angel takes an equity position. Some franchisors may also be reluctant to work with you if your funding is coming through an angel investment source.

The money you need is out there, so don't despair. Just be cautious in your enthusiasm and don't put everything you have on the line. Spread your risk, combine your funding sources, sell the stuff you don't use, and build those relationships.

Seeking other financing strategies

Some franchisors offer a menu of other financing strategies to ease the financial bite. Although not every franchisor makes these benefits available, it doesn't hurt to ask. Here are a few examples of some of these financing strategies:

- » **Deferred payments on your total franchise fee until after you're open for business:** The terms of the deferral can be a few months or sometimes a few years.
- » **Leasing the land, building, or equipment.**
- » **Joint ventures between you and the franchisor:** Where you and the franchisor share in the investment and return on the business — like a partnership.
- » **Supplier financing or leases:** Some equipment manufacturers offer new businesses — especially franchisees — financing on the equipment you buy from them or lease.
- » **Credit systems:** Corporate employees who want to be franchisees can apply profit-sharing credits toward the franchise fee.
- » **Reduced franchise fees for corporate employees who want to become franchisees:** This is a great employment benefit that gives the employee an opportunity to invest in a franchise at a lower cost. The franchisor benefits by getting a new franchisee who probably knows the system and with whom the franchisor already has a relationship.
- » **VetFran:** Vet Fran is a program established through the International Franchise Association that provides a variety of benefit programs to U.S. veterans. Each franchisor has developed different programs for their system. Information on VetFran can be found at www.vetfran.com.

Social Franchising and Funding

Chapter 17 discusses social franchising — using the franchise model to bring vaccines, contraception, clean cooking fuel, food, and other basic necessities to people in the developing world. Social franchising is a significant way in which

nongovernmental organizations (NGOs) assist the world's poorest regions. The model is similar to commercial franchising, but the bottom-line goal is not pure profit, although many social franchises do aim to become self-sustaining.

Obtaining funding in this context includes charitable giving in the form of social impact investment as part of the equation.

Social impact investment is any investment activity that has an expectation of both a social outcome and a financial return, which would usually be below market rate. It often represents a form of repayable finance that can be used for capital investment, revenue funding development, capacity building, or other ways of improving sustainability. It can take the form of most capital raises, including loans and equity investments, but also may include charitable grants and quasi-equity investments (where the lender takes their returns as a portion of the organization's future revenue), overdraft facilities (secured agreed credit if an account balance goes to zero), and social impact bonds (where investors put forward the capital required to run a project, and are repaid by the commissioner, usually government, based on the results or social impact of the delivery organization).

Social impact investors are like donors who seek a financial return and are willing to take more risk of loss to achieve a social impact. Social impact investors measure the return as a function of both financial return and social impact. Which way one leans varies, based on the investor's values and goals. They often want reports, pre-set deliverables, and metrics measuring the impact of the organization on the mission — how much good the organization is doing. The initial and future investment may be tied to success, and the investor may insist on participation in the organization and implantation of its mission.

Social franchisors require funding at various stages in the evolution of the program. An initial investment might fund prototype development and testing. This might be followed by further investment in the design and development of the franchise program (for example, professional fees) and the social franchise organization. Funding might also include raising the necessary capital to sustain the social franchisor through maturity. Where the social franchise program includes funding of franchisee startup costs, these capital needs also must be understood.

An often-overlooked element in NGOs is the requirement for basic business tools including training programs, operations manuals, and a structured approach to field support and the necessary supply chain. As part of the social franchisor's planning for seeking social investment and donations, these stages and requirement need to be clearly defined, and the capital required, without overpromising, must be clearly identified.

Often the social franchisor is challenged by the changes to their program tied to donor funding. The missions of the social franchisor and the social investor need

to be in alignment and must stay focused on the social franchisor's mission. Continually changing the offering of any business, especially a social franchisor, does not allow for the consistent and sustainable approach necessary in franchising. Where a social franchisor is willing to make frequent or material system changes to its franchise program in order to be the recipient of donor funding from additional sources, the ability to maximize any of the benefits of franchising are put into severe jeopardy.

Also, although reporting by the donor is expected, and the discipline it gives to the social franchisor is a wonderful counterbalance to an entrepreneurial or inexperienced management team, too much advice and assistance or advice and assistance that is periodic and conflicting can be very disruptive to an effective social franchise system.

Social franchisors, as with any well-developed franchise system, will create internal reports and measures to evaluate the system. Social investors and donors, though, may want the franchise system to adopt additional and often burdensome detailed reporting that strips the franchisor's efficiency. Making certain up front that the reporting package you use internally to manage the business up front with the donor will alleviate that problem. Donors participating in a social franchise organization need to understand that their flexibility in adapting to the social franchisor's reporting regimen rather than forcing an additional reporting obligations on the franchisor will improve the efficiency and cost-effectiveness inherent in well-developed franchise systems.

One of the inherent problems in an NGO's reliance on social investing is that social franchisors, as would be found in any commercial business, have a long-term view of their business out of necessity. Often donor funding comes with a short window and is based on the grant period. This is often too short for adequate planning by the social franchisor. The key here is for the social franchisor to seek longer commitment terms from the donor.

The goal of every social franchisor is to achieve adequate scale and internal resources as a franchisor to begin to wean itself away from the continuing cycle of responding to grant proposals. Where a relationship has been established with social investors and donors, there should be a clear understanding that although funding requirements may become diminished over time, there will likely still be the need for some support for a lengthy period. Donors that do not enter the relationship with that understanding may instead see the social franchisor as successful and move their donations to another NGO or social franchisor at an earlier time frame than a social franchisor requires.

As with social franchisors, donors also have missions on how they want to employ their capital. Many, rather than donate to the overall mission of the grantee, want

to target their donations to specific elements of the social franchise program. You will frequently see limitations that don't allow the donated funds to be used for overhead or administrative requirements and instead be "button holed" for specific and defined elements that the franchise system is trying to achieve. This has been one of the principle causes for problems in traditional NGOs, as it has required them to seek additional funding for other elements of their program, and in both a social franchise and an NGO it creates system stress that takes the focus of management off of its critical system mission.

As the social franchise system begins to expand, the normal and natural internal funding resources available from any franchise system should begin to limit the requirements for needed social investment and donations. As in any franchise system, these will naturally include franchise fees, royalties, income from supply chain sales, a la carte fees, and more. As these internal resources become available, with the need to continually seek outside funding, management can focus more of its time on the system's mission, which is the essential goal of any franchise.

Successfully structuring the relationship between the social franchisor and the social investor and donor can also be beneficial to the funding organizations. Once scale and internal resources are the mainstay of the social franchisor, the achievements of the social investor's focused approach reflect positively on the donor organization. With an increased competency within the social franchisor, to the extent the social investor has been seeking a return on its investment, at this point that possibility — not possible in a traditional NGO — is now reasonably possible.

Social franchisors and commercial franchisors . . . if there is a material difference, it rests in the mission. For the commercial franchisor, the purpose is making money and achieving a return on investment for its stakeholders. Social franchisors, while seeking sustainability and the opportunity not to require third-party funding, are mission-driven to the stated purpose of the organization: the delivery of high-quality medical services and prescription drugs or fresh water to consumers at the base of the pyramid. Losing sight of the social mission can reflect poorly on the social franchisor, its management, and the social investors and donors, if not properly managed.

At a point in time, as in any well-managed franchise system, the funding of a social franchisor may include traditional banks and other loan programs. Where the management of the social franchisor is unfamiliar with those more traditional approaches to business funding, it is essential for management to consult with professionals that can effectively guide them through both the economics of the transactions and the legal and tax requirements that may become necessary within the structure of the organization.



Operating Like a Well-Oiled Machine

IN THIS PART . . .

Evaluate potential locations for your franchise, negotiate leases, and build out according to your franchise's specifications.

Discover how to buy the things your business will need and check out purchasing groups and cooperatives.

Find out the critical importance of hiring talented employees and training them.

Explore the secrets of creating the best relationship between franchisor and franchisee — and among fellow franchisees.

Create winning marketing plans and implement national and local advertising ideas.

IN THIS CHAPTER

- » Evaluating and choosing a location for your franchise
- » Negotiating a lease for your chosen location
- » Building out and opening according to your franchise's specifications

Chapter 7

Choosing a Location

In many, though not all, businesses the selection of your location can be very important because the site you select needs to be convenient for your targeted customers to shop and provide you with visibility.

But finding a great site isn't always as simple as finding the busiest intersection. Before you can evaluate a potential location, you need to know who your potential customers are — and where they're coming from. Consider some basic questions:

- » What drives traffic to your business?
- » Where do your targeted customers live?
- » How and when do they want to interact with your business?
- » Do you rely on impulse sales, making high visibility essential, or are you a destination business where location is less important?

One of the roles of good franchisors is to provide you with guidance on the types of sites (from standalone buildings to strip centers to malls to home offices) that will work best for you. Franchisors should understand the demographics of the system's target customers and be able to alert you to the amount of rent and lease terms that would be reasonable for you to consider.

In this chapter, we give you tips on finding a great location, negotiating your lease, building out your site, and getting to opening day.

Selecting a Site

Depending on your franchise, you will be confronted with a host of different types of locations in which to establish your business. Good franchisors look closely at successful operations in their system and provide franchisees with profiles of what they consider ideal locations. Some franchisees rent office space in high-rise office buildings, others work from home, but most select from an ever-growing list of options, covered in this section.

Considering common site options

Here are some of the types of locations you typically will be looking at for your franchise:

» **Malls:** Malls — as you surely know — are large, enclosed shopping facilities anchored by two or more major retail stores and servicing a large geographic area. A mall is typically easily accessible by automobile via major arteries or interstate highways and is surrounded by a very large parking lot.

Selecting a well-developed mall requires a franchisee to balance the benefits and the drawbacks. The principal drawback of a mall is the cost, which includes not only the rent but a host of additional expenses, such as common-area maintenance — your share of caring for the public space. Malls also charge merchants association fees, used for advertising for all the tenants in the mall. You also usually have to operate during the hours that the mall is open.

On the plus side, malls are natural draws and attract large numbers of potential customers from as far as 25 or more miles away, depending on traffic patterns and competing malls. You can expect that some malls will include a percentage of your sales as rent (that's on top of your *base rent*). In addition to your franchisor having a say on what your location looks like, the better malls may restrict your ability to reimage.

Neighborhood centers: A supermarket typically anchors a neighborhood center with a variety of convenience-oriented small retail and service stores. These centers usually provide reasonable rents and draw from a trade area of from one to three miles, depending on population access and concentration.

Most neighborhood centers have few signage restrictions — though upscale centers or those in upscale towns can be as tough as regional malls when it comes to signage and décor — and are the type of location that retail and service franchise systems target for their franchisees.

» **Community centers:** These centers are also convenient for local populations. They usually have two or more anchors, a supermarket, a drugstore, and other general merchandise retailers. They serve local populations up to six or

seven miles away, depending on ease of travel and accessibility. They have appeal similar to the neighborhood centers but are much larger — and hence, may have more signage limitations for their on-street pole signs.

These are the types of centers that most often have available *out-parcels* (spaces for smaller, free-standing buildings out on the parking lot). The quick-service restaurant business uses out-parcels, as do other businesses that need to be closer to the street to be seen by passing motorists.

- » **Lifestyle centers:** Usually found near affluent residential communities, these open-air centers feature upscale national specialty chain stores, dining and entertainment, and fountains and other ambient design elements that make browsing the internal, uncovered walkways enjoyable — whenever the weather permits.

In these setups, traditional anchor stores typically are not dominant the way they are at malls. Multiplex cinemas, small department stores, large bookstores, and large-format specialty retailers are usually the biggest individual draws. These centers combine some lower-priced, impulse-purchase vendors trading off of the high traffic counts along with higher-priced, destination-type merchants. Often, these centers have parking at each of the retail stores and sometimes larger parking lots as well. They draw from up to 13 miles, depending on traffic patterns and convenience.

Be careful in choosing a site in a lifestyle center. They are excellent venues for compatible concepts, but they can be expensive mistakes if your concept is not a good fit with the *lifestyles* of the majority of the center's visitors. Most of the time, your franchisor will know whether these centers are a good bet for you.



WARNING

- » **Power centers:** Power centers are open air and usually located near a regional or super-regional center. They include at least three big-box stores (or *category killers*), such as Walmart, Target, Home Depot, or Costco. Power centers draw customers from a five-mile radius. A trend in many markets is to convert underproducing regional centers to power centers, because people like the convenience of the regional centers but prefer the option of parking in front of the store of their choice.
- » **Other centers:** Constantly evolving variations of developments exist where retailing, entertainment, employment, tourism, bargain hunting, and other activities come together. *Theme/festival* centers are heavy on entertainment and restaurant businesses for leisure and tourist activities. *Outlet* centers have great bargains and sometimes draw busloads of people from very far away. *Mixed-use* centers combine many activities in the same area: retail, restaurants, employment, transportation, sports, recreation, office, hotel, cultural, and other activities in various integrated combinations. *Specialty* centers can focus on restaurants, car care, off-price, and other specific types of businesses on a planned development parcel.

As with the more typical centers just listed, you want to be part of or nearby these centers to take advantage of the customer flows they create.

- » **Shopping areas:** A concentration of stores serving a local community is considered a *shopping area*. Downtown, also known as a central business district (CBD), is a shopping area that benefits from the traffic from office workers, visitors to downtown, and people who live in the downtown area. Because of the traffic and their prime locations, these sites can be expensive in some cities and often suffer from lack of customer parking. Because most of the traffic in the downtown areas is usually created by office workers, the hours during the weekdays are busiest, with most customers coming in before work, during lunch, and after work. This inconsistent traffic pattern makes staffing a bit problematic. Except for a few cities that have re-created their downtowns as entertainment destination areas or festival marketplaces for residents from the suburbs — as Baltimore did — these areas are often quiet in the evenings and on weekends and holidays.
- » **Off-street sites:** Airports, universities, ballparks, and co-branded locations are all types of sites that usually are not easily accessible to customers just driving or walking down the street. These locations represent significant opportunities for many franchisees today and represent a growing trend in franchising.
- » **At-home sites:** Although home locations are not sites in the traditional sense, more and more franchisees are choosing this option, where the franchisor allows them to work out of their homes. See the nearby sidebar for more on this kind of franchise location.

Working a franchise from home

Many franchise systems, especially smaller service franchises that never have customers coming to their offices — for example, carpet cleaning, janitorial, maintenance, and repair services — not only allow their franchisees to work from their homes but actually encourage it.

Working from home reduces a franchisee's cost of doing business and is convenient. For many franchisees, it's perfect. They can get up early, do their paperwork, and plan their day — all before taking a shower. In the evening, after dinner, they can relax in their offices, watch some TV, and prepare for the next day. And because they don't have any other office, they can deduct the costs associated with their home office on their tax returns. (Check with your accountant and tax preparer to determine what is deductible.)

Opting for alternate or off-street sites

Many franchisors are able to expand their systems by opening locations in off-street venues or captive-audience venues. These locations include gas stations, convenience stores, hospitals, airports, train and bus stations, colleges, large department stores, offices, factories, and movable kiosks at seasonal and recreation locations, sporting arenas, parks, and malls.

The strength of captive-audience (also called *mass-gathering*) locations is that the merchant benefits from customers drawn to the location by something other than the product they're offering. You might not go to a baseball game to eat but you'll be hungry by the sixth inning. The biggest drawback to a mass-gathering site is that customer flow is tied to the ebb and flow of people in the host environment. When the ballplayers go out on the road or when the season ends, you're out of luck. Colleges are governed by the academic calendar, so get ready to twiddle your thumbs a bit during summer vacation, unless many students attend summer school. Still, the traffic can be so high during the busy periods that these locations are highly sought after.



REMEMBER

If an airport location opens up, more road warriors go through a main terminal, concourse, or food court than through a regional terminal. Not every mass gathering opportunity is the same — do your homework.

Also, many mass gatherings may not be available to you because those locations are controlled by concession companies or other large businesses that sign long-term contracts with those venues. Check with your franchisor to see whether alternative venues are available to you in the area you have selected. Also, see if your franchise agreement excludes you from looking at mass-gathering locations altogether — many do.

Dual branding: Sharing your space

When two or more businesses share the same premises, we call that *dual branding*: Two or more franchises with different concepts set up shop next to one another or within the same location, offering customers a one-stop shopping experience. Think of a food court.

Yum! Brands, the parent company of KFC, Pizza Hut, Taco Bell, and Wing Street, often places two or three of its brands in one location. So do gasoline companies that often combine their gasoline stations with a convenience store offering sandwiches, doughnuts, and other food, along with a quick oil change or car wash businesses (often with multiple brands all at once).

A dual-branded location may be able to use labor and real estate more efficiently because, if done well, it expands a location's *daypart*. (In the restaurant industry,

breakfast, lunch, and dinner are called dayparts.) For example, doughnut chains, as you might expect, are usually busiest during the breakfast daypart and slow down during the lunch and dinner dayparts. Some, like Dunkin' Donuts, have begun to expand their offerings to expand their traditional dayparts to include lunch. Other concepts are slow during the breakfast daypart but busier during the lunch or dinner daypart. By dual-branding a location, the operator hopes to capture traffic generated by the other product offering and use the location more fully.



TIP

If you choose one of these dual-branded sites, you still pay an initial franchise fee and royalties and remain accountable to the same standards. Make sure your franchisor offers equipment, signage, and design specifications to fit these new locations. Compare the costs — and sales/profit potential — with those of single-branded locations. These sites are usually tucked inside another location and take up less square footage. The smaller space may mean less staff and possibly lower overhead. Some operate seasonally. But just because they're smaller doesn't mean they're cheaper. Some — such as limited-access highway travel centers — are on prime properties. The bidding can be fierce and the occupancy costs high.

Finding Your Franchise's Habitat

Finding a good retail or restaurant location in today's market is not always easy. Many of the best spots have already been taken, and competition for the available real estate is brisk. Given rapidly changing consumer traveling patterns, opening your franchise in the right location matters because if your operations and your location are great, you have the best of both worlds.



REMEMBER

Although a good location is important, a good or even great location won't make up for a bad operator. Given the choice between the old adage "location, location, location" and "operations, operations, operations," we opt for neither — but lean toward the latter.

Defining your location is a vital part of your business plan. Anyone financing your venture — even your moneybags uncle — will want to know where the cash is going, what the site will look like, why it will attract customers, how much customer traffic will pass the site, whether there's adequate parking, and who your neighbors and competitors will be.

You may luck into a site just by driving through town looking for FOR SALE OR FOR LEASE signs. A better approach is to use a local commercial real estate broker familiar with the unique aspects of your market. You will find that many, or most, of the better sites never have FOR SALE OR FOR LEASE signs on the property. The local brokers become aware of them or dig them out for you based on their business networks and experience.



TIP

Be sure your broker learns about your franchise system and site requirements or restrictions imposed by your franchisor. Another resource is the exhibitions where shopping center developers lay out their construction plans. Contact the International Council of Shopping Centers at www.icsc.org.

Finding out what constitutes a good site

First, you need to understand from your franchisor the criteria that are important for your type of business. You may think the best place to open your doors is where the crowds are right now, such as in a shopping mall or adjacent to a busy highway. You may be right — for now. But with all the acquisitions, mergers, and market pullouts happening with major retailers and grocers, that major draw your business is dependent on may go away and take your customers with it. At one point being close to a Sears store was a terrific choice because of its customer draw — that has changed considerably.

No one can offer a stock definition of a “good” site, because different businesses require different kinds of locations. Some generalities do hold up, however. If you’re investing in a retail franchise, focus your search on a location that gets in your customers’ faces. If it’s in the path of people commuting to work, near an entertainment arena, or in an office complex, customers can see your business, recognize your brand, and more easily come in to buy your products and services.

For some businesses, though, getting the best corner in town, with high visibility and terrific customer access in a strong, anchored shopping center, for example, is not only unnecessary but also the path to rapid disaster. Carpet cleaners, janitorial services, building-repair services, direct-mail companies, lawn-care services, pest-control businesses, moving companies, tool-delivery services, and home-inspection services, among other service providers, don’t usually need high-visibility retail space (and can’t afford it, either). Their needs run more to good-looking trucks, delivery access, access to postal facilities, highway access, warehouse facilities, and good telephone service than to locations where their customers shop. After all, most of these service providers go to their customers — the customers don’t come to them.



TIP

If you don’t need to be at the corner of State and Main, you’ll likely have more options, lower rent, and a more accommodating landlord.



WARNING

Also consider your potential neighbors and nearby competitors. If you’re operating a child care center, you don’t want to be next door to a liquor store. Being near a strong anchor store like a Target or a grocery store could help drive customers to your location, as long as the anchor store doesn’t monopolize available parking spaces or offer the same products or services as your store. If direct competitors are in the same retail center or shopping plaza, consider choosing a different location — unless your potential site out-positions them by being more visible or more

convenient for the customers you're competing for. But clustering with similar businesses may on occasion be advantageous, especially when the area is known for restaurants or the regulations for the sale of alcohol make those areas essential.

Some developers or landlords may not want or allow two businesses of the same type (for example, two pizza parlors) in the same complex, either for reasons of tenant mix or exclusivity rights granted in a lease. So, even if you don't mind moving in a few doors down from a competitor, the landlord may not be willing or able to rent to you. Understand these restrictions up front so you don't invest a lot of time and money on a site you can't get into.

Using the franchisor as your compass

Most franchisors can offer a big advantage: experience. The staff at a mature franchisor can help you identify the kinds of locations that usually work — and those that don't. For example, staff members know whether a franchise can be effectively home-based initially or even long term, whether an office is attractive or whether a retail franchise fares better tucked inside a suburban mall or flaunted center stage on a main thoroughfare. So, your first step in selecting a location is to discuss viable options with your franchisor. The company may allow a variety of locations, or it may stick to only one type.

A good franchisor points you in the right direction and can share with you the demographics that profile your potential customers:

- » Who are the system's target customers and where do they live?
- » How many customers do you need, say, of a particular age and income that can drive to your business in a certain amount of time?
- » How far are customers willing to travel to buy your goods or services?
- » How and when do customers typically interact with the chain — are you opening a coffee shop aimed at commuters, a fitness center catering to professionals on their lunch hour, a child care center that needs to be near residential areas, or a destination concept like a spa?
- » How much are your target customers willing to pay for what you sell?



REMEMBER

A good franchisor wants you to find a location that meets the needs of your target customers. Many franchisors use mapping software for locating areas best suited for your type of business. But you still need to double-check any information the franchisor supplies against your own research. Think of this as a check-and-balance. You check on the accuracy of the data, and your information provides a balance to what the franchisor offers. Frequently your knowledge of your market

will be a better gauge than even the best mapping software — don't rely exclusively on one source of information.

Many franchisors bombard new franchisees with *site criteria* — a list that spells out specifications for a particular franchise — inside and out, so that the site meets the franchise system's standards. You may be required to have *x* number of square feet, *x* number of parking spaces, *x* number of seats, *x* number of grills, venting requirements, and so on. Retail and restaurant franchisors, especially, expect their franchisees to comply with their design standards — without variation. On the other hand, an office-based franchise may not care whether you have wood floors or carpeting, mahogany desks or oak. A consistent look at each of the locations may not be important to franchisors, as long as the locations meet their overall quality standards.

Will your franchisor ultimately help you find this crown jewel of a site? Typically, a franchisor will educate you about its site criteria, provide you with site criteria forms, and ask you to find the location and do the required research — before you present the site package to the franchisor for review. Then the franchisor will evaluate your information and possibly visit the location before approving or disapproving your choice.

Check your franchise agreement to see whether and how the franchisor must approve a franchisee-selected site and the time limit for the franchisor to render a decision. (See Chapter 4 for more on franchise agreements.) Standard contracts allow a franchisor to accept or reject your request to open at a particular location. This decision, like everything else in franchising, reflects the need for consistency.

In almost every franchise agreement, the franchisor is only approving or rejecting a site, not guaranteeing it. This is true even if the franchisor found the location for you — you didn't have to accept it, did you? The franchisor's approval indicates only that the site is acceptable to them but ultimately, the selection of the site is your responsibility.



REMEMBER

The more hands-on support the franchisor provides in site selection, the better your chances of finding a successful site. Look at your franchise agreement to find out what your franchisor will do for you. Ask the other franchisees in the system how good the franchisor's site-selection assistance actually was.

Typically, the franchisor will approve a general area for your location and expect you to search within those boundaries for a location, unless the franchisor already has a site in mind. After you find a site, the franchisor's role is to accept or reject it. Other franchisors — especially startup franchisors — may physically accompany you on your site hunting. The staff may jump in the car with you, plot demographics, and talk to landlords. Some franchisors may already have located the site, built the building, outfitted it with equipment and fixtures, and made it available for you to buy or lease.

Using data to evaluate a site on your own

Investigating a site for your franchise is like following the scientific method. Suppose you hypothesize that a given site may be a good location. You need facts to support your hypothesis before you can reach any conclusions. The factors that influence site success fall into four primary categories:

- » Demographics and employment
- » Activity generators
- » Physical and traffic
- » Competition

Most demographics studies today can present information based on census tracts, block groups, zip codes, a radius measured in miles from a center point, drive-time polygons, and many other configurations. For retail and restaurant franchises, the drive times are usually best (except for walk-up locations) because most people will drive to your business — either coming from someplace or going to someplace else. Given a specified amount of time (3 minutes, 20 minutes, and so on), some computer programs that franchisors use can draw an irregular polygon based on vehicle speeds on the various roads and highways and then provide demographic and employment information for the contained area. These polygons usually vary dramatically from the comparable circles of 1, 5, 10, or 20 miles. The size of an area you should measure is most important. If your customers are quick-lunch types who typically drive no more than a couple minutes each way to get lunch, measuring the employment population ten minutes out won't help you. The franchisor can usually give you assistance in determining the size of your *trading area* (the area where you draw the majority of your customers).



WARNING

As you look for a site, keep your eyes peeled for red flags. A location that keeps turning over or that has been on the market for a long time should raise eyebrows. You may want to consider a different location if pedestrians would have to cross a busy street or drivers would need to make a U-turn to get around a median to get to the site. If anything — and we mean *anything* — smells fishy, investigate before you sign a lease. Do *not* let your desire to find a site and open your store trap you into selecting a substandard location.

Protected and Exclusive Areas

You must understand what, if any, protections your franchise agreement provides for your site and the surrounding area. You need to understand the concepts of

territorial exclusivity and *encroachment* before — not after — you sign your franchise agreement.

Suppose you open a franchise on the corner of Fifth and Main. Some years later, another franchisee from the same system opens a franchise on Fourth and Main. The new franchise is so close that you can see your customers going in and out of the new location. That's what we call *encroachment*. Whether encroachment is allowed depends on your franchise agreement.

Carefully examine the language of your franchise agreement. Are you getting a *protected* territory, *exclusive* territory, or do you have no territorial rights? If your franchise agreement grants you only a site address franchise (meaning your protected territory is no bigger than the four walls of your store), the franchisor could conceivably establish or allow other franchisee- or company-owned locations nearby that will compete with you. Obviously, encroachment can potentially have an adverse impact on your business.

Your franchise agreement may grant you an exclusive or protected area. Say your franchisor has granted you an exclusive territory stretching one mile around your location or for a specific trade area outlined on a map. The franchisor then is prohibited from allowing another franchisee- or company-owned location to open closer than a mile from your store.

Your franchise agreement provides you with a protected territory. Encroaching from another franchisee- or company-owned location opening in your protected territory may be allowed. Your franchisor may also sell products in other locations — such as a supermarket or a convenience store — in your protected territory. With an exclusive territory, encroachment can occur through Internet sales (if customers can buy through e-commerce the same products you sell) or catalog sales (from catalogs mailed into your market). It can also happen if your franchisor's affiliate allows others to offer similar products and services in your neighborhood under a different business name. It depends on what the franchise agreement says about your territorial protection.

Some franchise agreements state that a franchisor or its affiliate may sell items through other channels of distribution (like catalog or online sales) or establish other units under different names and trademarks in direct competition with a franchisee. Because e-commerce sales don't require the establishment of a location, they may not legally be encroachment unless specified. Never assume you have rights not provided in the agreement.

One of the reasons you chose to be part of a branded system is that you don't want to be the only one of your brand in the market. Left all alone, you will be vulnerable to competitors who will have no problem with opening next door to you, especially

if you're part of a weak brand with little penetration and you're unable to advertise sufficiently. Good franchisors try to achieve a balance to create brand recognition in the marketplace and, therefore, create more demand for the products and services of the franchised brand so that everyone in the chain can benefit.



TIP

You need to know — before you sign the franchise agreement — whether the franchisor will be able to open locations in your market area. Your co-author Joyce Mazero, lead franchise attorney at Gardere Wynne Sewell LLP in Dallas, Texas, cautions: Contracts normally tell you what the franchisor is granting, such as the right to operate a site, but sometimes don't plainly tell you what it's not granting, such as no right to exclusivity outside of the site, no right to conduct business on the Internet, and no right to prohibit the franchisor or another franchisee from operating from a site close to your site. What you're getting is just as important as what you're not getting.



REMEMBER

Never rely on a franchise salesperson's statements about what the system generally does or doesn't do regarding its locations. Even if they make sense when saying that the franchisor would never open a location so close to you that it would adversely affect your business, get the language in writing in the franchise agreement (as with everything else that's important to you).

Encroachment Policies

Although it may not be a contractual obligation, some franchisors have an encroachment policy, and you should see if your franchise system does. With an encroachment policy, a franchisor allows a franchisee to protest a new store's development, and then based on research — which generally the franchisee pays for — the franchisor may reconsider whether or not to open that new location close to yours. Keep in mind that a policy is not the same as a contractual obligation, and the franchisor can change or even eliminate a policy, which they can't do for obligations contained in a written agreement.

If it seems that the encroachment will cause a prolonged and material adverse impact, a franchisor may decide not to allow the development of the new location. If it appears that the encroachment will cause a minor or temporary impact, the franchisor may allow the unit to be developed but may also assist the affected franchisee to make up for the lost sales. Other franchisors simply cite the terms of the affected franchisee's agreement and allow the unit to open — regardless of the extent of the impact.

Find out the franchisor's policies and practices on protected territories and encroachment impact before signing the franchise agreement. Read your franchise agreement. Speak to other franchisees and talk to your attorney.

Signing the Lease

After you find the perfect location, the real work begins: convincing the landlord to give you a lease you can live with. Many times, a landlord may be unfamiliar with your business. Worse, they may have a negative perception of your type of business. They may simply be naïve, have bad information, or possibly have had a bad experience with a past tenant who offered similar services or goods. Explain why your business is different, who your customers are, and the benefits the other tenants will receive from your business. If your concept is national in scope, give the landlord a sense of the prestige his center will receive by being part of the system.



TIP

When you're looking for sites, think of yourself as the seller, not the buyer. Your job is to *sell* the potential landlord on the merits of your business. Your franchisor should provide you with marketing materials to present to landlords. Give landlords a reason to pick you over other businesses.

By the time you're about to sign a lease, you've already decided on a location. You should be in the process of contacting the real estate or mall management company that manages the property to determine space availability and specific occupancy costs and lease terms, and to complete your site review package for your franchisor. Your franchisor may want to see a letter of intent with your landlord in the site review package.

Be financially realistic in signing a lease. A great location is no good if you can't afford it. Based on the experiences of other franchisee- and company-owned stores, a reputable franchisor is often in a good position to tell you what rent and lease conditions are reasonable.

Does the center have adequate space available for your business? Although you don't want to squeeze into a space that's too small, you also don't want to pay for space that you'll never need. Square-foot costs can vary with overall size — often, the larger the space, the lower the square-foot cost. But even with a lower per-foot cost on a larger space, the maintenance and development costs will be higher. Evaluate size based on your needs.

Confer with your franchisor regarding your proposed lease. Although most (but not all) franchisors won't negotiate your lease for you, many insist on reviewing and approving any lease before you sign it. Keep in mind that this review generally is *not* for your benefit and doesn't reflect the franchisor's judgment of whether the lease is fair or a good deal. Instead, a franchisor's review is aimed at confirming that the lease contains certain terms required by the franchisor. For example, many franchisors insist that landlords agree to assign the lease to the franchisor, at the franchisor's request, if the franchise agreement is terminated. Check your franchise agreement for any terms your franchisor requires to be included in your lease and always work with an experienced real estate lawyer in negotiating any lease.

The numerous intricacies of negotiating and signing commercial leases are well beyond the scope of this book. Check out *Negotiating Commercial Leases & Renewals For Dummies* by Dale Willerton (Wiley, 2013).

Meeting Your Franchise's Requirements

You'll generally be expected to develop your location to meet the site development requirements and standards of the franchisor, including layout, décor, signage, furniture, fixtures, and equipment. Although franchisors use several methods, most will provide you with a layout that they expect you to have an architect or builder recast to meet the requirements of your location.

Implementing a franchisor's designs

Every retail and restaurant franchisor has a floor plan (called a *footprint*) that may be excruciating in its exactness. Even if you think that a counter should be two inches longer on the left side, you have to follow the franchisor's plans — or get the franchisor's permission for a change. Even if you know for a fact that menu signs are more readable if they're placed 12 inches closer to the floor than the required 90 inches, too bad — you have to follow the plans. Review these specifications and standards with your architect and contractor.

Franchisors usually provide prototype plans for every location. Your architect must develop plans for your site that meet local ordinances and codes as well as the franchisor's standards. Don't assume that you can add improvements to the design, such as a bigger *back of house* (the kitchen and storage area).



WARNING

Check with your franchisor before making expensive changes that you may have to reverse.

All these specifications from the franchisor are intended to ensure consistency, which is great, but what if your particular community has some type of restriction that runs counter to your franchisor's building plans? Make sure that you notify your franchisor so that you can discuss the required changes. If the changes are important, the franchisor often personally contacts the builder or city planner to discuss the changes.

Generally the franchisor will provide you with a list of sources for the equipment, décor, and other items you'll need to purchase. Before you open your business, you will generally need the franchisor's approval that your development of your location meets its standards.

Getting approvals, permits, and licenses

Whether you're renovating an existing leased site or building a new site from scratch, you'll have to prepare preliminary plans and specifications for construction and site improvement for approval and permits from your local zoning board and building department. You'll also have to — big surprise! — submit them to your franchisor for approval. Your banker or lender will also want to see these plans.

If building a site is going to be your choice, make sure you touch base again with the local zoning board and building department before you even close on the property and certainly before you move that first shovel of dirt. You want to be in compliance with *everything* — down to local ordinances that set the hours you can hammer and saw to your heart's content. You also want to determine whether the town needs to approve any *variances* (which give you permission to do something on the land that's different from what the zoning rules allow) for the property and whether the site will support your needs for utilities, parking, and the like.



WARNING

Early discussion with the municipality is important. Even in cases where your use is permitted, the planning board may have some unusual requirements that could make the site unworkable for you. Sometimes green-space setbacks or water-retention basins, although nice for the ducks, can push your building out of sight of approaching traffic. If your business relies on impulse purchases, you would be in a tough spot.

Although your contractor or architect usually does the pre-construction legwork, seeing that it all gets done is your responsibility — not the franchisor's. Your contractor needs to obtain the following:

- » **Permits:** For construction, utilities, signs, *curb cuts* (those indentations in the sidewalk that let the cars in), and environmental matters
- » **Variances:** If you need the town to approve some specific violation of the zoning requirements for your site
- » **Certificates of occupancy:** To allow you to occupy the location

Beginning construction

After your franchisor approves your site plan, it will be your responsibility to build out the location to the franchisor's standards and to meet local building codes. Critical to the build-out process is selecting a reputable commercial contractor who has experience with meeting deadlines, securing necessary permits and approvals, and complying with the quality requirements imposed by your franchisor. Your franchisor (and other franchisees) can tell you how long the construction process typically takes.

Getting help with the opening

Many franchisors provide in-person assistance immediately before and during a location's grand opening. The amount and nature of such opening assistance varies greatly by system. Some franchisors send a single field consultant to observe and be available to answer questions during a franchisee's grand opening, whereas other franchisors send a team of field consultants who arrive up to a week before the grand opening and stay until they're comfortable that the franchisee is ready to run solo. Such pre-opening and opening assistance can include the following:

- » Providing guidance on the type of marketing and advertising a franchisee should conduct for the location's market introduction and grand opening.
- » Placing initial orders of opening inventory and supplies.
- » Conducting additional on-site training of the franchisee and its management team. As discussed in Chapter 9, many franchisors historically have provided some training to a franchisee's staff at the franchisee's location in connection with the opening; however, due to fears of being declared a joint employer of a franchisee's staff, franchisors are increasingly providing train-the-trainer programs to franchisees and then expecting franchisees to train their own staff.
- » Ensuring initial compliance with brand standards.

Check your franchise agreement and Item 11 of the FDD regarding the opening assistance you can expect to receive from your franchisor.

- » Buying the things your business will need
- » Checking out purchasing groups and cooperatives
- » Understanding key issues that affect your expenses in running your business

Chapter 8

Getting the Goods

You are going to need to purchase a lot of things for your new business. From the capital goods required to complete your buildout, to the inventory you will need to make the products or deliver the services you will be selling, to things you might not have thought of, like office supplies, paper wraps, cleaning supplies, and all the disposables you are going to need for maintenance. Where you buy and how much you should pay can become complicated.

Consistency is important, and each location in a franchise needs to operate in a way that ensures every customer receives the *same* quality of goods and services, regardless of where the franchise location is. Notice we didn't say *close* to the same quality. Unless the franchisor decides otherwise, your products and services need to be *exactly the same* as every other location delivers to the system's customers. Achieving this level of consistency requires franchisors to exercise some control over what you buy and where you get it. Everything — from the products you sell, to the ingredients and supplies you use, to the décor, FFE, and build-out that will be the face and look of your business — will be part of the supply-chain standards most franchisors will specify and require you to follow.

Having a uniform supply chain is a good thing and will benefit both the franchisee and franchisor because in a well-managed supply chain the franchisor strives to ensure that your costs are normally lower than you can buy independently. To achieve brand standards, they also want to ensure that what you buy is of high quality and consistency, and that the ordering and delivery process is efficient. What you want is a supply chain that can deliver the right product, at the right time, in the correct quantity, and at the right price.



REMEMBER

The franchisor is licensing to you a system for operating your business in accordance with its brand standards. The supply chain is an important part of every franchise system, requiring its own infrastructure and costs. Some franchisors manufacture some of the products you will sell, but many outsource their supply chain services to third parties like manufacturers, suppliers, and distributors. In either case, the franchisor will incur some expenses in order to support its supply chain, and therefore, many franchisors earn revenue from their supply chain activities. This revenue will be in addition to the royalties and other fees franchisees pay to the franchisor. Although the goal is typically to ensure you are able to purchase what you require at a lower cost, other factors may impact a franchisor's supply chain decisions, and you are not assured of being able to buy at the lowest price possible.

The Basic Requirements

Suppose you've purchased a maid service franchise, and your business will be going to customers' houses to make them sparkle better than any of your competitors. You have hired a first-rate staff, and you have trained them to scour, wipe, dust, and polish better than anyone else can. But elbow grease is not going to be enough. After all, your employees are going to need cleaning products, vacuum cleaners, wipes, and other disposables. They are going to need uniforms and maybe even booties to put over their shoes. Similarly, if you chose a sandwich chain, making certain you have high-quality breads, proteins (meats and cheeses), vegetables, and condiments for your sandwiches is going to be vital.

Because consistency is essential, you likely will not have the option of simply hopping over to the local warehouse store and loading up a cart or buying everything from a local vendor. This may be true even if the product you can get from the local warehouse store is identical or just as good — in your opinion — as that is being specified by the franchisor.

In some cases, you may actually have only one place to buy what you require, and purchasing directly from the franchisor or from an affiliated company may be your only option. For example, IHOP prides itself on its proprietary pancake mix, and Wetzel's Pretzels prides itself on its proprietary pretzel dough. These special ingredients result in the high-quality products that consumers look forward to buying at each chain and are competitive strengths of each system.

Some franchisors will specify one or a just a few approved suppliers, whereas others may allow you to choose your own vendors as long as the suppliers satisfy the franchisor's required standards and specifications. Many franchisors use a combination of these approaches.

Each franchise system is different, but don't expect franchisors to allow an unlimited number of authorized suppliers because the cost is too high. There is the potential strength in franchising that may benefit purchasing, and most franchisors strive to obtain better prices and gain efficiencies by consolidating system purchasing volumes with a limited number of suppliers. The benefit is that when franchise systems buy in large volume, lower prices and other potential benefits such as supplier-supported advertising and equipment programs may become available. But that's not always the case and you need to determine this when conducting your due diligence on the franchisor you are selecting.

As Len MacPhee, franchise and supply chain attorney with Gardere Wynne Sewell LLP in Denver, Colorado, puts it, "Mandatory purchase arrangements and restrictions on sources of supply are common and can be beneficial in multiple ways. Benefits include ensuring consistency and quality of the products and services offered at retail units across the brand, as well as substantial economic benefits when the collective buying power is leveraged and the supply chain professionally managed. When evaluating a franchise opportunity, a prospect should review and evaluate not only the mandatory purchase requirements and restrictions on sources of supply, but also the allocation between franchisor and franchisees of the benefits of cost savings and rebate and markup revenue."

Meeting Approved Standards and Specifications

It's up to the franchisor to set brand standards and select and monitor the suppliers it chooses. Your responsibility is to follow the franchisor's contractual requirements by using only the franchisor's approved or specified suppliers when they are provided and by buying only products and ingredients that meet the franchise system's specifications.

Making mandatory purchases

If a franchisor specifies suppliers, absent a waiver from the franchisor that allows you to purchase from someplace else, your only option is to purchase from those approved suppliers. Don't expect the franchisor to change its methods simply because you want it to.

This section explores some of the more common arrangements for how franchisors enforce system standards by ensuring consistent ingredients and supplies for the franchise system.

Most franchisors look at supplier pricing as a basket of goods, and you should not expect each individual item in the basket to be at the lowest price possible. You likely might even be able to purchase some of the exact same products at lower prices by going down to the local warehouse store. When done well, the basket of goods and services is negotiated with the goal of keeping the entire basket's cost lower, but the supplier still will need to make a profit. If you were allowed to cherry-pick from the basket, the relationship between the franchise system and the supplier may be impacted — meaning the overall costs to all other franchisees could be impacted if you don't meet your obligations.



REMEMBER

Franchisors take supply chain violations quite seriously.

The franchisor as the sole supplier

For some goods or services, your franchisor may be your sole or exclusive source. When that occurs, the requirement usually extends only to items that are proprietary (secret recipes), contain certain key ingredients, or are branded with the franchisor's trademark. These products may be ordered directly from the company, or, in many franchise systems, the franchisor provides the products to the distributors or licenses another company to produce and oversee distribution to the system. Because these items are proprietary, don't expect any franchisor to provide you (or any supplier you recommend) with the specifications for the franchisor's proprietary ingredients or products.

Suppliers approved by the franchisor

Rather than serve as the exclusive or sole source for all required purchases, some franchisors simply give franchisees a list of approved suppliers from whom they can or must buy their items directly — and the franchisor (or one of its affiliates) may be included on that list. The franchisor and the suppliers will have agreed on what specific products can be supplied to the system as well as alternatives should any of the specified products be out of stock. The choice of alternative products is not for you as the franchisee to make. Trusting the supplier to meet system standards is an important part of why the franchisor selected the supplier in the first place. As long as the approved suppliers sell franchisees only the items approved by the franchisor — without unauthorized substitutions — a franchisor can have significant confidence that it is maintaining the control it believes is necessary over the quality of the products sold under its brand.

Compliance with quality standards is a core principle of their business, and franchisors will reject and replace any supplier that does not produce and make available products that satisfy those standards. As a check on quality and service standards, franchisees need to report to the franchisor any issues or problems they are having with an approved supplier.

Most franchisors allow franchisees to request the franchisor to approve new or alternative suppliers (or approve new products or approve new or modified product specifications). If you discover that a supplier in your market meets your franchisor's criteria and is less expensive than the franchisor's authorized suppliers, make sure to pass the information on to the franchisor. If you feel strongly that you should be able to purchase items from this supplier, make a formal request for approval of the supplier. If acceptable, the franchisor may add the supplier to the list of approved suppliers once it has vetted the supplier, often by ordering and inspecting products produced by the supplier or visiting the supplier's facilities.



WARNING

The costs for vetting requested new suppliers are often passed back to the requesting franchisee, so be discerning in your requests.

The franchisor will often reserve the right not to approve a proposed supplier for any reason, even if the supplier appears qualified to you. Keep in mind that there is more to being an acceptable supplier than the price of a single item. Smart franchisors evaluate many factors in considering whether to approve a proposed supplier. For example, does the supplier have the capacity to supply the entire franchise system with quality products on a timely basis, a proven track record, competitive prices and do they have financial stability? And if the current supplier is providing volume-based rebates or other incentives to the franchisor and the proposed supplier won't do that, the franchisor may choose not to approve the proposed alternative supplier. Also it's reasonable for any franchisor to limit how many suppliers it works with.

Rebates and upcharges

It's not unusual for franchisors to receive money based on franchisees' purchases of required goods and services. This happens either because the franchisor is selling products directly to franchisees at a markup (called an *upcharge*) or is receiving payments or benefits from the designated suppliers and distributors (a *rebate*). Franchisors frequently apply upcharges to proprietary products manufactured and supplied directly by the franchisor to cover the franchisor's product development, manufacturing, sourcing, distribution expenses and to earn revenue.

Some franchisors may receive up-front or annual payments from suppliers and distributors in exchange for access to the system's franchisees, exclusivity to a particular product or service, or the franchisor's commitment to a long-term purchasing arrangement. Franchisors may also receive marketing fees or require equipment packages or special delivery arrangements from suppliers that benefit the system. This is common when the franchisor has agreed to feature a particular supplier's brand or products in the system's retail stores — think of Coca-Cola or Pepsi coolers or dispensers in fast food restaurants.

Many franchisors will also negotiate *volume rebates* from suppliers. These rebates are payments from vendors to the franchisor based on the number of franchisees buying from the vendor or the system's overall volume of purchases of the vendor's products.

Aggregate or total amounts of rebates and other benefits that a franchisor receives from vendors and the percentage of purchases from approved suppliers in relation to your overall investment should be disclosed in the FDD (see Chapter 4). Franchisors are not required to disclose specific rebate amounts for specific suppliers.



TIP

Review rebate information in the FDD carefully so you can get a sense of whether the franchisor is deriving significant revenue through the purchases you will make as a franchisee. Finding out in advance is important because some systems with a lower royalty rate may actually cost you more money than a system with a higher royalty rate, because the difference may be more than offset by the income the franchisor earns from your purchases. (The *royalty* is your payment to the franchisor that allows you to continue in the franchise system — it is usually based on your total sales.)



REMEMBER

The supply chain revenue received by the franchisor is generally factored in as part of the franchisor's own revenue model. Where supply chain revenue is not available, the franchisor would still require that revenue to manage the system and earn its own return on investment, which may result in higher royalties or *à la carte* fees being charged.

In addition to the information in the FDD, you should check with the franchisor about the way rebates and upcharges are handled in your system. The procedure is far from uniform among franchisors or among suppliers. Some franchisors will keep the rebates as revenue — often it offsets the costs of negotiating and monitoring the approved suppliers, but it may be used to offset franchisor expenses generally. Other franchisors will forward the rebates directly to the franchisees. Some franchisors will place some or all the rebates into a marketing fund for the benefit of the whole system. Still others will use a mix of all of the above.

It is generally acceptable for a franchisor to earn money when you purchase goods from a supplier. After all, setting up and maintaining these supplier relationships cost the franchisor, unless the system has an independent cooperative or buying group (covered later in this chapter). And franchisees need to have a financially strong franchisor that can provide the services they need and want.



TIP

In a perfect world, you want to find a franchise system in which the total costs of being a franchisee (royalty and other costs) are the lowest, and the services provided by the franchisor are the highest.

Many of the legal disputes over the past two decades have resulted from franchisees' perception that they are getting gouged — that is, the products they must purchase from the franchisor or its approved suppliers are excessively marked up, making the franchisee less competitive. **It is essential that prospective franchisees and the franchisor talk about supply chain policies and requirements including margins and rebates.** However, where the franchisor has properly disclosed how it conducts the supply chain before franchisees invest, franchisees have little to complain about after the fact. Understanding the supply chain relationship is important before you sign any franchise agreement.

Finding your own suppliers and requesting approval

Franchisors frequently allow and even encourage franchisees to find and choose their own vendors — as long as the franchisee complies with the product standards and specifications set by the franchisor. This practice is common in small franchise systems, but even big franchisors often allow franchisees to buy certain items locally, especially where those items are commodities, the brands for off-the-shelf items are reliable, or the franchisor is focused on local sourcing of certain items like fruits and vegetables from local farmers. If your franchisor doesn't provide you with a list of authorized suppliers, you may have to choose your own vendors. Often this can be time consuming and add some cost to your investment. Knowing which items you can choose suppliers for and the specifications that must be met is important.



TIP

Work with your field consultant and your franchisor's purchasing department to see whether they can help you identify suppliers in your market. Your local chamber of commerce may also have a list of suitable suppliers. If your franchisor offers a supplier-evaluation questionnaire, get it and use it. If not, make your own. And talk to other independent business owners in your market, including franchisees from other franchise systems. Make certain you do some basic online research on suppliers. The Internet can be a vital source of understanding how well suppliers work with their customers and what their reputation is.

When you review bids and quotations from vendors, make sure you understand the total charges. Some vendors quote a low price on a product but add on handling and delivery charges. Some reserve the right to modify or change prices unilaterally. Look for these hidden charges or reserved rights when you compare pricing.

Price is certainly one of the prime considerations, but basing your decision solely on price can be a mistake. A good price on items that are constantly out of stock or a good price from a vendor who is trying to dump outdated merchandise won't help you build your business. Consider product quality, order accuracy, and timely delivery in selecting a vendor. Having a vendor that will help you in a crisis may be more important than saving two cents a case for an item.

The Role of Buying Groups and Purchasing Cooperatives

Several franchise systems use buying groups or cooperatives to collectively purchase products, marketing, advertising, insurance, leasing, credit, and other goods or services. This sharing of responsibility can be a powerful advantage to franchisees and franchisors when structured properly.

The approach to buying groups and cooperatives is by no means uniform in how they function and who they represent. Many are started by franchisees, and the franchisor is not part of the buying group. Other cooperatives include both company-owned and franchisee-owned locations. Still others represent members from several franchise systems.

Many franchisors actively support cooperatives formed by their franchisees because it helps support and strengthen the growth of the overall brand. A *buying group* or *cooperative* is normally a separate legal entity with members made up of the franchisees who have committed to make all their purchases of certain items through the buying group or cooperative. The buying entity will negotiate the supplier arrangements and facilitate its members' purchases on generally uniform terms.

Generally, cooperatives are set up to take advantage of certain tax benefits and are controlled by the members on a one-member, one-vote basis with officers, directors, policies, and procedures established for the cooperative's operation. A cooperative may have employees or outsource certain functions. Cooperative members may also have the opportunity to participate in *patronage dividends*, which, similar to stock dividends, are financial distributions of the cooperative — only patronage dividends are generally based on the amount you purchase from the cooperative (the more you buy, the more you get back), whereas stock dividends are based on the number of shares you own.

Of course, cooperative must meet the standards and specifications of the franchisor and the cooperative will only be able to sell approved products and services through approved suppliers. There are cooperatives in nearly every industry, especially within the fast food and restaurant markets, including popular brands like Burger King, Subway, Taco Bell, IHOP, Applebee's, Arby's, Ace Hardware, and Dunkin' Donuts. Some also provides information technology (IT) infrastructure services for the chain.

In 2009, IHOP and Applebee's created a franchisee purchasing cooperative for the benefit of both brands. Co-author Joyce Mazero acted on behalf of IHOP and Applebee's in establishing that cooperative. In the 2014 annual report of Dine-Equity, the parent company of IHOP and Applebee's, CEO Julia Stewart stated that the franchisee-owned and -operated cooperative "has enabled our franchisees to

realize approximately \$215 million in total net savings and cost avoidance since its inception in 2009.”

Receiving merchandise

If you own any business, you have to figure out how to manage your *receipt of merchandise*. You must properly check, log in, and store all the goods, supplies, ingredients, and other merchandise entering the store. Even if you negotiate lower prices for your merchandise, you won't save any money if you don't notice unacceptable quality or shortages in shipments. To avoid these losses, you or the store manager must establish a regular receiving routine for your store. Having a routine helps to monitor vendors and reduces the chance of shortage. If your franchisor provides you with a list of recommendations and procedures for maintaining your inventory, follow it. If not, the following sections offer useful guidelines.

Having suppliers make their delivery through your front door during your busiest hours is going to be disruptive. Make certain you select suppliers that work with you on their hours of delivery, frequency of delivery, and how they deliver to your business.



TIP

Many reputable companies offer what's called *key drop* delivery. The vendor has a key and makes a delivery during off hours, such as at night or early in the morning. Often the business will have a refrigeration unit accessible from the outside back of the location where deliveries are made. When the delivery is made, and in situations where refrigerated or frozen product are delivered, they are placed in the middle of the cooler or freezer with the dry goods placed in middle of the stockroom floor.

In the morning, the merchandise is checked in, and if there is a disagreement a call is made and, where appropriate, a credit is issued. This type of delivery is frequently offered at a lower cost for delivery because it allows the driver to travel when there is limited traffic, allowing the driver to make his deliveries faster. In some cities there may be restrictions on the size of truck that can be making deliveries in the retail and business districts during the normal business hours.

Receiving deliveries

Suppose you have just purchased a convenience-store franchise. The new site has been built, and you're standing inside your brand-new building. The only problem is that the shelves are empty. Soon you will need to begin scheduling and receiving deliveries. Follow these general tips for receiving merchandise at any type of franchise:

- » **Make sure suppliers schedule their deliveries in advance.** Accept deliveries only during specified hours. When the location is open and operating, you

want the merchandise to come during off-peak hours so that you can concentrate on accepting the delivery.

- » **Don't let vendors park in front.** Require vendors to park in an out-of-the-way spot. The front of your business is for customers.
- » **Have the delivery driver bring all products into the building before you check the items.** Some systems want their own employees to bring merchandise into the store.
- » **Confirm that the merchandise you receive is for your business.**
- » **Check all vendors in and out.** Be sure you physically see every item — don't take the driver's word. Check all cartons and boxes when the vendor is leaving to make sure they are empty and no merchandise is being carried out of the store. Unless absolutely necessary, vendor check-in should be done away from that vendor's display and away from merchandise on hand. Don't allow a vendor to both stock shelves and remove boxes unless you check both before the vendor leaves.
- » **Watch helpers.** Some vendors have "helpers" whose main job is to distract you during the check-in process.
- » **Immediately put away all perishable products.**
- » **Check use and expiration dates.** Sometime vendors have relationships with other customers where merchandise that isn't past the expiration date is removed before that date. If you receive that merchandise, the time available to you will be shorter than you need or want.



WARNING

Checking the goods after they are in your location

A truck pulls up at the back door of your franchise, and a flurry of activity follows. Suddenly, you're surrounded by boxes. The driver is completing the paperwork for your signature. This situation does not have to be scary if you know what to do. Check the quality and condition of the merchandise before accepting it. Here are some additional tips:

- » **Examine every box for signs of damage.** Look for things like tears, broken or crushed cardboard, signs of tampering, rattles, damp or wet cardboard, bad odors, dented cans, and substitutions of standard items.
- » **Before signing for the boxes, open any cartons that have been opened and resealed or that you suspect have internal damage.** Note any damages on the receiving record.

- » **Always check the date code on the product when it is delivered.** Make sure the product is within the code and that you can reasonably expect to sell it before the code expires.

Verifying invoices

Attending to paperwork may be the least entertaining part of business ownership, but in the case of delivery receipts, it can prove rewarding. Avoid financial losses by ensuring you get what you pay for. Check out these tips:

- » **Before accepting delivery, check each item on the delivery receipt against the product that has been delivered and compare against the product ordered.** Check quantities received against quantities ordered. Count the number of cartons delivered and compare this number to the number on the driver's record or freight bill. Never sign for more cartons than you receive. Note any discrepancies on the freight bill or receiving record, or correct the errors before the vendor leaves the store.
- » **Never give the delivery receipt back to the vendor.** Obtain the delivery receipt when the vendor walks in and under no circumstances return it to the vendor. Manipulating the delivery receipt is one of the most common ways that some vendors steal from franchise locations.
- » **If the vendor made a substitution, call your franchisor's field consultant to verify that the substitution is valid and acceptable.** Inform the driver and note on the invoice that substitutions not approved by your franchisor are subject to return for full credit.
- » **If you don't receive an item appearing on the delivery receipt, have the driver clearly mark the item "Short" along with the quantity not received.** The driver should sign the delivery receipt before you sign it.

Maintaining Inventory

Your franchisor should teach you about maintaining your inventory. Procedures vary widely, depending on the type of franchise you own. Your franchise may not even have any inventory — in that case, skip this section.

Back of the house

The *back of the house* includes the *stockroom*. It is literally in the back area of your business, and it is where you keep all the items not currently in use. If you need

more vitamins, you go to the back of the house and get them. Back of the house is also where you store perishables and frozen items, which means it also can be the location of a refrigerator or freezer. You will be expected to know what you have in the back, too.

Your franchisor should provide detailed back-of-the-house storage procedures that may include a *plan-o-gram* so you can readily know what you have in stock. Follow them. If your franchisor doesn't provide information on back-of-the-house arrangements and procedures, the following sections provide some procedures to consider.

Dry storage

Dry storage may be wet — sorry. The term is used for items that don't require refrigeration. If you're a health-food franchisee, your vitamins and sports drinks are dry-storage items. The following are some dry-storage practices:

- » Store products at least six inches off the floor on clean, nonporous surfaces to permit the cleaning of floor areas and to protect from contamination and rodents.

PLAN-O-GRAMS

Plan-o-grams are frequently used in retail locations because they give the merchant instructions on where to display products. In some systems they tell the merchant how many *facings* (the number of rows) they should have of each product and the amount of products on each shelf, hanger, or merchandiser. Most retail franchisors will provide their franchisees with detailed plan-o-grams. Where some of merchandise is branded and some is generic, the franchisor will often specify the branded merchandise at eye level with the generic merchandise down by the consumer's knees. When the product is targeted to a child, the franchisor will generally put that merchandise at the eye level of the child and not the parent — assuming that little Peter and Mary will see it first and pester Mom and Dad to buy it for them.

Franchisors frequently provide franchisees with plan-o-grams for back of house stock, both for dry storage and also in the refrigerated and freezer area. The reasons for doing so is different than for the front of the house but no less important. By specifying a plan-o-gram for back stock, the franchisee can quickly see when they are low on certain items and can also better manage that the goods they have in stock are fresh. A bad stocking plan can allow for goods to be buried behind others, and this can increase waste. A plan-o-gram also enables a franchisor's field consultant to quickly see how the franchisee is managing their inventory because each franchisee will use the same methods for storage.

- » Don't store products under exposed sewer or water lines, or next to sweating walls.
- » Store all poisonous materials — including pesticides, soaps, and detergents — away from food supplies, in designated storage areas.
- » Store all open packages in closed and labeled containers.
- » Keep shelving and floors clean and dry at all times.
- » Schedule cleaning of storage areas at regular intervals.
- » Date all merchandise upon receipt and rotate inventory on a first-in-first-out basis. Place older products in front of newly received merchandise.
- » Locate the most frequently needed items on lower shelves and near the entrance.
- » Store heavy packages on low shelves.
- » Don't store any products above shoulder height.

Refrigerated storage

If you have items needing refrigeration, place them into your cold storage as soon as you can. Here are some tips for storing your refrigerated items:

- » Enclose any food or other product removed from its original container in a properly identified, clean, sanitized, and covered container.
- » Don't store foods in contact with water or undrained ice.
- » Check refrigerator and freezer thermometers regularly.
- » Store all foods so that there is free circulation of cool air on all surfaces.
- » Never store food directly on the floor.
- » Make certain the temperature setting is appropriate for the product(s) you are refrigerating.
- » Clean your equipment and refrigerated storage at regular intervals.
- » Date all merchandise upon receipt and rotate inventory on a first-in-first-out basis, placing the oldest products in front of the newly received merchandise. This step is particularly important with refrigerated products because their shelf life is usually short.
- » Establish preventive-maintenance programs for equipment.



REMEMBER

If you're using frozen products in your business, follow the appropriate steps in defrosting them. This is essential to ensure that the products you sell to your customers are safe to consume and also will have an impact on the quality of the products you serve to your customers.

Front of the house

The *front of the house* is everything that's not the back of the house. This is the area that customers see when they enter your store. Obviously, how the front of the house looks is more important for locations that are frequented by customers and less important for locations that customers never see. If you're a retail location, you'll handle your merchandise differently than you would if you were a restaurant. Still, at all times, the front of the house is your showcase — it is what customers see every time they visit your store.

Retailers need to place merchandise on shelves so that it's attractive to customers and induces them to buy. Restaurants and other businesses that sell food also need to keep their locations attractive. If you have reach-in refrigeration accessible to your customers, or if you have items on display, how you display them is just as important to you as it is to a retailer. Your franchisor should provide you with a plan-o-gram for that purpose.

To keep the front of your store in tip-top shape, make it a priority to do the following:

- » Follow your franchisor's plan-o-gram.
- » Keep your shelves and *merchandisers* (displays for your merchandise) stocked, clean, and dust free.
- » Use proper product rotation by placing the oldest products in front of the newly received merchandise (first-in, first-out).
- » Price identical items the same. One benefit of point of sale (POS) technology is that you don't have to reprice each item when prices change — just change the price in the POS and on the shelf's price tag.
- » Allow adequate space between displays, as required by your local code.
- » Use only signage that is acceptable in your system. If your franchisor requires you to use professionally prepared signage, don't use hand-written signs. Equally important, make sure you keep your signage current. (Remove the Christmas posters after Santa has returned to the North Pole — before New Year's Day.)
- » Clear the floor of empty boxes, unless they're part of the design concept.



REMEMBER

The Americans with Disabilities Act requires that you keep your store arranged in a manner that makes it usable for individuals with disabilities. As a general rule, provide enough space for easy passage of a wheelchair throughout the store, make sure that the lines to your registers are accessible, and don't display merchandise in a way that makes it difficult for people with disabilities to shop. If you have no choice about how you merchandise the store, make sure that your staff is actively available to any customers who may need assistance. As the business owner, complying with all federal and local laws is your responsibility.

IN THIS CHAPTER

- » Implementing good training before and after you open your franchise
- » Hiring talented employees
- » Following the Equal Employment Opportunity Commission (EEOC) guidelines
- » Interviewing applicants
- » Fostering a good work environment to retain good staff
- » Ensuring workplace safety

Chapter 9

Training and Hiring

As an independent business owner, every employment decision you make has far-reaching implications — on your sales, your budget, your bottom line, your aggravation level, your customers' satisfaction, and, of course, on your being able to achieve brand standards. If you want to be customer-focused, you have to be employee-focused, and that includes making certain your entire staff is trained and supervised to deliver on your system's brand promise.



REMEMBER

Great franchisors are going to give you some training and tools to recruit, train, motivate, and manage your staff — but they're not going to execute any of it for you, and it's up to you to decide which policy the franchisor recommends you want to adopt. How human resource policies are enforced and how staff is managed on a day-to-day basis are the responsibility of the business owner, and in franchising that means 100 percent of the responsibility is on the franchisee.

In this chapter, we give you tips on complying with various employment rules and hiring, training, supervising, and motivating your staff.

Getting Good Training for Yourself and Your Management

Great franchisors insist that franchisees learn the business and keep learning as the system changes and market conditions evolve. But don't expect that all you will need will come from your franchisor. Franchisors are going to deliver to you the basics, but today franchisees seek and obtain the information they need to operate their businesses from nearly unlimited sources including the Internet, local classes, and especially from their own professional advisors.

Getting good initial training

A new franchisee should expect to cover a lot of ground during the initial training. Your initial training will be focused at teaching you and your managers how to produce and deliver the system's product or service consistently to brand standards, but franchisors will include other important subjects as well, including the following:

- » Site selection, design, and development
- » Supply chain, vendor relations, purchasing, receiving, stocking, and inventory management
- » Food safety and storage (if the franchise is a restaurant or a store selling food products)
- » Labor management, including recruitment, supervision, and motivation
- » Leadership and business management
- » Brand standards and operating procedures
- » An understanding of the customer experience
- » Technical operations on products and services
- » Problem-solving
- » *Brand positioning* (how the franchisor wants the public to think and feel when hearing the brand name)
- » Merchandising
- » Pricing strategies and methods
- » Marketing and advertising

- » Cleaning and maintenance
- » Safety and security
- » Financial management and business plan development
- » IT, including point of sale (POS), accounting, payroll, inventory, and communications hardware and software systems
- » “Train the trainer,” to enable the franchisee to train their own management and staff on an ongoing basis

Good training instills in the franchisee the franchisor’s brand philosophy and history, teaches franchisees things they need to know (from opening the business in the morning to closing at night), and gives them the sources for additional or emergency support.

Today, because of franchisors’ concerns over claims of *joint employment* (more on that shortly), mainly fueled by the National Labor Relations Board (NLRB) and the Department of Labor (DOL) actions in support of SEIU and other unions’ organizing efforts, most franchisors are moving away from directly training their franchisees’ staff. Instead, franchisors are increasingly including train-the-trainer programs as part of initial training to give their franchisees the capability to train their own management and staff.

How much training a franchisee can expect to receive from its franchisor will depend on the industry, the complexity of the business, and especially on the franchisor. Your franchise agreement will provide you with information on what you should expect to receive. For details on the franchisor’s initial training curriculum, look at Item 11 in the franchisor’s FDD. The methods franchisors use in training their franchisees vary widely.

Although most of a franchisee’s initial training will take place at a franchisor’s headquarters or possibly at another training facility, more and more franchisors are including online training for franchisees. There are many benefits of online training for franchisors and franchisees. Through online training, franchisors can enhance the amount and detail of the training provided without requiring the franchisees and their management team to spend an extended period of time away from home. In addition to reducing a franchisee’s travel and other costs, online training ensures that each franchisee receives consistent training and enables franchisees and their staff to go through the training at a pace best suited for themselves.

Emerging franchisors may be limited in how they deliver training to their franchisees — frequently a copy of the operations manual and a new franchisee training class are the only training assistance a new franchisee will receive. Even so, given that frequently the founders of the franchise system are still very much

involved and there are few franchisees in the system that require support, franchisees can still expect to receive a significant dose of training from new franchisors.

You need to understand how much training you're going to receive from your franchisor. In some systems — even some of the largest franchise systems — a franchisee can expect to receive only a few days of training, which may be limited to working in an operating location. The amount of classroom time and the training you might expect to receive in managing your business can be very limited in those systems.

In other franchise systems, franchisees may spend months in training. That training will include both classroom and on-the-job training and will extend into additional training at the franchisees' locations before and during the opening of their business.



TIP

Don't expect every franchisor to provide the same depth and length of training. In conducting your due diligence on a franchisor, it's up to you to make certain that the training the franchisor provides is sufficient for you to operate your business. Talk to existing and experienced franchisees in the system before you sign the franchise agreement to determine whether the franchisor's training program and training staff are able to deliver what you will need. Also ask them what other training they recommend you take that may be available from sources other than the franchisor.

Receiving effective ongoing training

In established franchise systems, in addition to support that comes from the franchisor's headquarters, field support is often provided from a franchisor's regional offices. Smaller and emerging franchise systems may only have their headquarters staff available to provide franchisees with local training support and ongoing management assistance.

With the rapid changes in products, services, competition, technology, and regulations, operating a franchise today requires constant evolution and improvement. Most franchisees can't do that alone. You should not expect the franchise you invest in today to be the same exact business you will be operating next year, let alone in five years.

To help you as your business evolves, franchisees should expect their franchisor to provide more than initial training. Expect your franchisor to require you, your management team, and your training personnel to attend continuing training programs. Even when the training is only recommended and is not mandatory, smart franchisees will elect to consume every training program a franchisor has

to offer. That is only being a smart businessperson — assuming your franchisor has a history of great training programs.

In some franchise systems, the franchisor's field staff is the main delivery vehicle for new training. In addition to showing up at your business armed with operational, marketing, and organizational support, they also train the franchisee and their management team on the rollout of innovations, such as the preparation of new products or the operation of new equipment.

It is the hallmark of a great franchisor to continually offer new products, updated research, state-of-the-art technology, better methods of customer service, and other improvements to continually enhance the brand in the marketplace. These changes keep a company more than one step ahead of the competition. In modern franchise systems, much of this continuing training on improvements to the brand will be provided not only by the franchisor's field staff, but also through the franchisor's intranet system online.

Understanding Joint Employment and Why It Spooks Franchisors

We mentioned actions by the NLRB and the DOL in support of SEIU and other unions' recruitment efforts. Unfortunately for franchisees and franchisors, these regulatory actions are changing how franchise systems are managed and how a franchisor can support a franchisee today. And these changes, while benefiting the unions, are not beneficial to you as a franchisee.

Who is the employer anyway?

Question: Who is the *employer* of a franchisee's employees? The question may sound simple, but the answer today may not be obvious. The franchisee is the sole employer of its staff. With the exception of required brand standards, franchisors generally don't have any contractual rights to directly control any of the human resource practices independently established by the franchisee. But under certain circumstances, the NLRB and the DOL would like franchisors to be deemed *joint employer* with their franchisees to make it easier for unions to organize workers.

Private sector labor unions have been in decline for decades, and today less than 6.5 percent of private sector workers are members of a trade union. This is a decline from proximately 35 percent in the 1950s. Because franchisees have the sole responsibility to make all human resource decisions like hiring, firing,

disciplining, supervising, and directing their staffs, unions have never been able to effectively organize franchisees' employees.

Recently the NLRB and DOL's Wage and Hour Division have led efforts to expand the definition of *employer* administratively in support of SEIU's desire to organize franchisees' staff. To overcome the problem of independent business ownership, the NLRB and DOL administratively changed the recognized standard of employer from direct control and expanded it to include indirect or even merely potential control. As franchisors and franchisees share a brand and franchisors are required to establish brand standards, the NLRB and DOL have sought to include brand standards as an indication of indirect or potential control. By changing the recognized historic definition, the NLRB and DOL have dramatically expanded the definition of *joint employment*. When two companies like a franchisor or franchisee are found to be joint employers, the major benefit to SEIU and other unions is that it makes union organizing possible in franchising. This change has also impacted many additional industries, including those in which independent contractors and others in the gig economy work today.

The NLRB and the DOL's revised definition is being challenged by franchisors and others in court. Congress is considering legislation to overturn the administrative decisions of the NLRB and the DOL, and several states have recently enacted laws setting the prior standard as the law in their states. It can be expected that under the Trump administration the joint employer definition will be returned to its historic meaning by the NLRB, reversing its administrative ruling. However, at the date this book is being written, the new secretary of labor has not been confirmed by Congress, and the two vacant seats on the NLRB board necessary to administratively return to the old definition have not been appointed. Stay tuned. When the change takes place, we will include the revised rule on this book's companion website.

The change in the definition of joint employer has caused some disruption in franchising in the past few years, and franchisors have changed how they support their franchisees to avoid triggering a claim of joint employment. Until the joint employer definition is returned to its historic meaning, you can expect to see franchisors change things like training, support, and even the software provided to you as a franchisee.

The role of the franchisor in human resources policies

A franchisee is responsible for developing and implementing their own human resources policies. Even with the new joint employer standard, franchisees can still ask their franchisor for recommendations on human resource policies and samples, and most franchisors will be able to provide that material.

Traditionally, franchisors have included a human resources section in their operations manuals and training programs and have also provided their franchisees with scheduling and other human resource–related software to help franchisees better manage their businesses. When included, the manual may provide the franchisee with recommendations and sample materials on the following:

- » Applications and other hiring tools
- » Guidance on anticipating management and staffing needs (which vary depending on volume, type of location, and maturity of your business)
- » Hiring evaluation
- » Human resources paperwork
- » Interview preparation
- » Interview questions and techniques
- » Job descriptions and staff responsibilities
- » Job features and benefits you can use in recruiting candidates
- » Profiles of the types of candidates you should be looking for
- » Recommended pay plans and bonus plans
- » Recruiting sources
- » Recruiting techniques and strategies
- » Recruiting tools such as brochures, ad slicks, letters, in-store signage, and so on
- » Reference checklists
- » Telephone techniques for recruiting
- » Disciplinary policies
- » Scheduling recommendations

Increased sensitivity to the potential liability of looking like a joint employer to its franchisees' employees is causing some franchisors to reevaluate the type of support and guidance provided to franchisees for employment and personnel matters. As a result, some franchisors are deleting the human resources section from their operations manuals. As an experienced franchisor lawyer and franchise consultant, your authors view this as an overreaction by franchisors when they make these types of changes. Both your authors recommend getting a second opinion should your lawyer recommend removing the material, as modifications can be effective.

Although franchisors want to avoid the appearance of control over a franchisee's personnel decisions, it is important for franchisees — many of whom are new to managing a business — to have this beneficial support. In addition, franchisors are still entitled to implement controls over their trademark, advertising, quality control, unit appearance, and other uniform standards intended to protect the brand or the quality of customer service. Interestingly, these types of control are precisely the requirements for being a franchisor under the FTC Rule and are also necessary to protect the franchisor's intellectual property under the Federal Lanham (Trademark) Act. Unfortunately — and this is part of the challenge franchisors and others are facing — the new NLRB and DOL joint-employer standard conflicts with other requirements under the federal law.

Training Your Staff

A franchisee can and should expect franchisors to provide ongoing training on issues impacting the brand and customer experience, including defining all the brand standards the franchisee is responsible for achieving.



REMEMBER

Training your staff is the most important thing a franchisee can do. You can be the best-trained franchisee in the system, but if your full-time and part-time employees don't know how to provide the product or service, ring up sales, keep the store clean, and offer a positive customer experience, you are not going to get happy — and repeat — customers.

Consider that at most amusement parks it is the sweeper and other staff who do not work directly with park attendees that get a lot of questions from families throughout the day. That's why great theme park operators like Disney and Six Flags put a lot of effort into ensuring that even their janitorial staff understands what park attendees need. Great franchisees do the same. Every member of your staff should be expected to know and deliver on the brand experience the consumer has come to expect.

The training of your staff is going to be part vocational and part philosophical. Employees need to know their specific tasks, maybe even be cross-trained in several roles, but they also need to understand the franchise system's culture. It is the ability to understand and deliver on your culture that is the lifeblood of any business.

So, who is responsible for training your employees? It depends on the system and often on the specific job, and a franchisee should review the franchisor's FDD to see whether the franchisor offers initial or ongoing training to the franchisee's employees.

Often training is limited to a franchisee's managers, assistant managers, and shift leaders, and sometimes that training is only provided for a franchisee's initial management team. Often when training is available for replacement management personnel, the franchisor will charge an additional fee for that training.

As a franchisee, you should expect to pick up the transportation and lodging costs if any of your staff have to go to a franchisor's training facilities. Given such costs, a franchisee should find out whether continuing training is available at a closer, regional office or online through the franchisor's intranet site or via webinars to avoid have your staff trek to a franchisor's headquarters and spend a lot of time away from your business.

Historically, most franchisors have provided some training to a franchisee's staff at a franchisee's site when the franchise first opens. However, because of the new joint-employer standard, more and more franchisors are providing the franchisee with a train-the-trainer program and require franchisees to train their own staff. In those cases, the franchisor's field staff or field trainers merely observe and assist the franchisee in training their own personnel.

When ongoing training is available at a franchisee's site, that training usually is provided for an additional fee. Many franchisors also provide training programs on their intranet sites — a useful tool for franchisees to use in training new staff or refreshing training for existing staff.

Taking responsibility for getting your gang in gear

What is the best way for a franchisee to train their employees? There is no one right answer to that question. Some franchise systems work best if franchisees handle all the training. In that kind of franchise it is critical that the franchisor teach franchisees how to train their employees. That advice may sound confusing, but think about it: How can you teach your employees about their job duties if you've never been taught how to teach?

A franchisor that takes training seriously (like a great franchisor should) will load up its franchisees with training manuals, pamphlets, checklists, and audiotapes to ensure consistency. Tech tools such as CD-ROMs or training programs on the franchisor's intranet sometimes enliven the training program with everything from music to interactive games; the best part is that such materials can be continually popped into a computer to train new employees or refresh memories. Many are reinforced with printed materials and online training on the franchisor's intranet through distance-learning programs.



REMEMBER

How a franchisee uses franchisor-provided training material in training its staff is totally up to the franchisee. After all, the franchisor is not really interested in how a franchisee's staff is trained; a franchisor is interested in how well the franchisee's location *meets brand standards*. Keeping this in mind, the franchisee is free to use and modify the franchisor's training material as it finds beneficial for its business.



TIP

Franchisors also often address some training issues at the annual meeting and welcome a franchisee's management team into continuous training, including some national and regional training seminars. Franchisees should always take advantage of a franchisor-provided training program and send their staff to conferences and seminars when available.

Teaching someone how to do something is a skill — maybe even an art. Simply saying, “Here, watch me” is not adequate training. Therefore, a franchisee who is expected to train their staff must receive train-the-trainer instruction so that they have the needed skills. If the franchisor doesn't provide a train-the-trainer program, the franchisee should look for local programs or online materials to provide the necessary skills.

When English isn't an employee's first language

Sometimes for many among a franchisee's staff, English is not their first language. When that occurs, a franchisee should ask their franchisor whether training materials are available in the franchisee's employees' primary language. Where it is not, a franchisee should modify the material provided so that the staff that does not use English as their primary language can still fully understand how to properly conduct their positions.

Providing online training enables franchisees and their staff to access the franchisor's training program when they have the time to focus on learning. A franchisee should find out to what extent online training uses engaging visuals and graphics to convey content to the franchisee's employees if the franchisee anticipates some employees will have low reading levels or do not have sufficient capabilities in English.

Although online training may sound exciting, simply posting reading-intensive material may not help train staff. People learn differently online than they do in person-to-person classes. Online training materials need to be developed in a manner proper for online delivery, which often requires training modules and other written material to be delivered in shorter segments than usually found in live presentations.

Marla Rosner, senior learning and development consultant at MSA Worldwide, underscores the importance of the franchisee's role in developing a team of competent and service-oriented employees. "Franchisees wear numerous 'hats,' from marketer to bookkeeper and in some cases chief cook and bottle washer (literally). They have to be prepared and committed to either execute staff training provided by the franchisor or create training regimens themselves. There will always be competing demands, but if staff training is ignored or compromised, the product or service and customer satisfaction will deteriorate. If a franchisee cannot find the time to train, they should assign the training function to someone on their team."



REMEMBER

The day-to-day follow-up and supervision of your staff belongs entirely to you. Your employees are your front line — they create the first impressions your customers get from your business. And those first impressions are lasting ones. So, your employees need your ongoing attention and input — they are an important part of the recipe for operating a successful business.

Finding a method to the madness

When training a new employee, you should avoid a sterile, lecture-like approach. Encouraging the new employee to ask questions and get involved is essential. Keep in mind that although a new employee may have the right attitude to do the job well, they likely lack the experience and skills necessary to work effectively. A basic four-step approach works best when teaching an employee manual skills:

1. Prepare the employees.

Explain to the employees the task they will be doing. The employees simply observe someone else doing the skill and asks questions.

2. Present the information to the employees.

Let the employees do the tasks. Slowly lead them in the process while you explain how to do each step.

3. Let the employees practice.

Have the employees do the task, but this time let them explain each step while performing the task at half speed. Provide the employees with coaching and advice as needed.

4. Follow up to see what the employees have learned.

Have the employee perform the task at full speed, without any coaching or assistance. This step tells you whether the employee is ready to work independently and with your customers on that specific task.

Congratulate the employees when they've mastered the new task. Doing so instills pride in doing a good job. Go back and observe the employees periodically to make sure they're still doing the task correctly and have not picked up any bad habits.



TIP

Break down the skill into easy-to-understand portions. If the skill is to learn how to clean a restroom, work on sweeping and washing the floor separately from cleaning the mirrors, the washbowls, and other fixtures. The job may be cleaning the bathroom, but the task is the individual components of the job. Similarly, if the staff is responsible for keeping the front of house clean, don't expect them naturally to know that cleaning the tables before they sweep or mop the floor is the proper order to make their job easier. It's your job as a franchisee to ensure that your staff has the skills and tools required to do the job well.

Building and Leading Your Team Effectively

In any business, effective leadership is critical. Franchising includes another layer: Effective franchisors lead to effective franchisees, which lead to effective employees.

Franchisors should not pass the buck here. Regardless of any concerns regarding joint employment, franchisors should recognize that they must give their franchisees the training and operations guidelines necessary to help them hire and train high-quality staff. After all, it's the franchisee's staff that is representing the brand to the consumer.

Regardless of what a franchisor suggests in its manuals or procedures, a franchisee is responsible for its employees — not the franchisor. Even when a franchisor includes sample forms and recommendations in its manuals, a franchisee should carefully verify all of their employment procedures and human resource policies with their own attorney or other advisors. After all, many human resource policies need to meet local or state laws, and many will change from time to time.

It's essential that a franchisor clearly communicate its corporate culture so all franchisees can transmit it down the line to their staff. A franchisor's corporate culture is the central focus of every great franchise system because it defines the brand in the consumer's mind. How it is delivered at the local level needs to meet how you communicate it in your promotional messages and in your local and community image. It must be supported by each location's achievement of delivering on your brand promise consistently. It must also be evident in how a franchisee's employees interact with each other and with the franchisee's consumers, vendors, and everyone else who comes in contact with the franchisee's business. Although the franchisee's staff don't work for the franchisor, they are the brand's ambassadors to the consumer.

Familiarity with the corporate culture can help a franchisee's staff make many day-to-day decisions, even when they haven't received any training for that particular situation. The right answer — even when the situation is new — will be easier to find if they have internalized the culture of the system.

It's up to a franchisee's leadership to convey to their staff what the culture of the brand really means. It should be the rallying point or, better yet, the “fabric of the system” that transcends the manuals, the forms, and the written procedures. It generates in every staff member a level of ownership in the brand and loyalty to the system. The power of a staff that understands the brand's culture can be a compelling tool for a business's success.

We spend a lot of time talking about the franchise system's corporate culture, but we would be remiss if we didn't talk a bit about the franchisee's own corporate culture. Each staff member should understand that they work for you and not for the franchisor. After all, they were hired by you, they get their payroll check from you, and they get their W-2 at the end of the year from you. Whereas the franchisor has its brand promise, you as a franchisee have a duty to *localize* that brand promise to your consumers in a way that enhances the experience for the consumer. Taking the basics of the franchisor's corporate culture and melding it — indeed, improving upon it for your consumers — is what makes great franchisees terrific operators. A franchisee should lead by example. If a franchisee maintains high standards, that tone is set for its employees. Then — you guessed it — the franchisee will be the role model for its employees.



REMEMBER

Until now, you've been relying on your franchisor a lot. But employment is one area where franchisors have to step back a bit. From a legal standpoint, how much franchisors can tell franchisees what to do in regard to human-resources issues is unclear, so many franchisors avoid making certain requirements. These are the *franchisee's* employees, and the franchisee is responsible for selecting them and managing their day-to-day conduct.

There is a silver lining in this cloud, though. Franchisors can make suggestions, and when they own corporate units, they can show actual case histories — of recruitment strategies, wages, bonuses, training, promotions, work schedules, filling out government forms, and so on.

Many operations manuals contain links to EEOC policies (more on those shortly) and may provide sample interviewing guidelines and sample recruitment materials. (Some don't, because franchisors and their lawyers are sensitive to the potential liability of looking like joint employers to franchisees' employees.) When a franchisor doesn't include this information, a franchisee can always tap its fellow franchisees to see what is working for them. That is plenty more information than you would get as an independent business owner.

Recruiting the right team and rewarding them in the right ways

As desperate as you may be to staff your business, hiring anyone who walks through the door doesn't make much sense. You want to hire only the best. By developing the reputation of offering a great place to work, you will attract quality candidates. The result will be better customer service, less employee turnover, reduced cost of recruiting new employees, and reduced cost of training new employees — in short, more profit.

As an employer, you also need to be conscious of one more thing: the law. You have the right to be very fussy, but you also have to be fair. This and the next section help you find and attract potential employees and stay within the laws while wooing them.

Are you resourceful? Good. You have to be for this job. Finding employees boils down to putting in time and effort, thinking creatively, and, usually, spending some money. In a tight labor market, you have to try everything and anything once — and then four more times — to see what works.

Before you start recruiting, do a little planning:

- » **Have an idea of how many employees you need and when you need to bring them onboard.** Your franchisor's operations and training manuals may provide recommendations to help with this process. You're a step ahead if your own business plan spells out what you will require.
- » **Make sure you have clear job descriptions.** Franchisors typically help you out here with sample job descriptions. They also usually provide you with information on employee profiles to look for and to avoid. Although not perfect in every situation, the employee profiles can provide you with a good tool to work with as you learn the business. But you should only use the franchisor's recommendations as your starting point — after all, these employees will be your staff and will be working in your business.

After you write up the job descriptions for your business, decide how many employees you need, and figure out when you want them to start, you're ready to go out and find your workforce. Your recruiting options are many — some pricier than others (and some are even free!):

- » **Use word of mouth.** Spreading the word is a great way to start your search. Just as with marketing, talk up your business to friends, relatives, neighbors, and other businesspeople. People are often in the market for new jobs or know someone who is.

- » **Begin a referral network.** When you hire your employees, you have begun a referral network. Happy employees are your best marketers. They love to bring in others — especially when they have an added incentive. Many franchisees offer rewards such as cash, concert tickets, or other prizes for every referral that is hired. Advertise the program on bulletin boards, in newsletters, and at employee meetings.
- » **Recruit at your site.** You can also use your site to give customers a heads-up; they are the perfect captive audience! Many franchise systems use outdoor billboards, counter cards, crew buttons, tray liners, job posting centers, and recruitment messages on carryout bags. You may want to put a sign in your window: HELP WANTED, HOMEMAKERS: SPARE CASH FOR YOUR SPARE TIME OF STUDENTS: SPARE CASH BEFORE AND AFTER CLASSES are just a few ideas.
- » **Tap into the community.** Churches, community organizations, schools, and colleges are all good recruiting sources. In some areas, employers can claim a tax credit for hiring at-risk youth and other hard-to-employ residents. Contact the Department of Housing and Urban Development at 202-708-1112 or online at www.hud.gov to find out whether you're in a federally designated zone. Government agencies, local chambers of commerce, and nonprofit groups can help you locate senior citizens and the developmentally disabled.
- » **Use job postings.** Online job postings through web sites such as CareerBuilder.com (www.careerbuilder.com), Craigslist (www.craigslist.org), Monster (www.monster.com), Indeed (www.indeed.com), and Zip Recruiter (www.ziprecruiter.com) are increasingly popular hiring tools. See whether your franchisor offers recruitment ad slicks you can use; they can also guide you on the appropriate media.

Recruitment ads, just like every other advertisement you use in your business, need to be professional and well designed to be effective. Many franchisors produce sample advertising material you can customize for your location.

Though old-fashioned, classified ads remain a potentially effective hiring tool, you can also look beyond the “help wanted” sections of your local newspaper. Other possibilities for classified placement include school publications, senior-citizen newsletters, trade journals, and hospital and other employers’ internal newsletters.

- » **Use employment agencies and executive recruiters.** Agencies and recruiters, which typically charge a flat fee or a percentage of salary per hire, may be a good option for some positions, such as management or other staff that require certain skills or licenses.
- » **Network within your franchise system.** Consider this: A wonderful employee at a franchise in Florida is relocating to Tempe, Arizona — exactly where your franchise is located. You have just hit the jackpot! You get someone who not only has glowing references but also knows the system.

» **Try several other methods.** Host open houses or so-called “discovery days.” Contact your local department of labor and/or participate in career fairs. You can also contact vocational and trade schools, college placement offices, religious advisors, community agencies, and other neighborhood stores or retailers.



REMEMBER

Don't forget to review any applications you have on file from the last time you had a job opening. Who knows? Maybe someone who didn't quite make the cut last time is available and interested.



TIP

Job opportunities may come across as more inviting if conveyed in a personable image. As a job seeker, think about which would you choose: a mega-supermarket that has a stark white sign in the window with **HELP WANTED** printed in black ink, or a full-color poster or billboard with pictures of happy workers that says **JOIN OUR TEAM — IT'S NOT A JOB, IT'S YOUR FUTURE.**

Remember that your franchisor has rules about how you use the franchise's logo in advertising, and those rules don't only apply to the ads you use to attract customers. Many franchisors provide franchisees with sample advertising for the recruitment of personnel, but if they don't, and you need to create your own, check with your franchisor for permission before you use the franchise's marks in your recruitment advertising.

In addition, emphasize — go ahead, even boast about — how you stand out from the crowd. People like to work on a winning team. Perks such as bonuses, child-care reimbursement, and career advancement could make you the employer of choice.

Following equal opportunity guidelines

The one word a franchisee never wants to hear while operating its franchise is *discrimination*. We urge you to become extremely familiar with the employment laws designed to prevent discrimination. Discriminatory practices include bias in hiring, firing, promotion, and job assignment. The U.S. Equal Employment Opportunity Commission (EEOC) enforces these federal labor statutes — you will want to be in touch with this agency to find out about the laws (www.eeoc.gov).

These are the major statutes:

» **Title VII of the Civil Rights Act of 1964** prohibits employment discrimination on the basis of race, color, religion, sex, or national origin. Sexual harassment and harassment on the basis of race and/or color or national origin violate this act.

- » **The Pregnancy Discrimination Act** prohibits discriminating against a woman because of pregnancy, childbirth, or a medical condition related to pregnancy or childbirth.
- » **The Age Discrimination in Employment Act (ADEA) of 1967** protects job applicants and employees who are 40 years of age or older from employment discrimination based on age.
- » **Title I of the Americans with Disabilities Act (ADA) of 1990** bans employment discrimination on the basis of disability.
- » **The Equal Pay Act (EPA) of 1963** prohibits discrimination on the basis of gender in compensation for substantially similar work under similar conditions. It applies to most employers.
- » **The Immigration Reform and Control Act of 1986** makes it unlawful for an employer to hire any person who is not legally authorized to work in the United States. Employers must verify the employment eligibility of all new employees. E-Verify (www.uscis.gov/e-verify) is an Internet-based system that allows business to determine employment eligibility. Employers must complete a Form I-9 for each new employee to verify the identity and employment authorization of that employee.
- » **The Genetic Information Nondiscrimination Act (GINA) of 2008** makes it illegal to discriminate against employees or applicants because of an individual's genetic information or family medical history.



TIP

For more information, contact the EEOC headquarters at 800-669-4000, contact any of its 50 field offices in the United States, or visit the EEOC at www.eeoc.gov. Also, check with your local department of labor or state attorney general's office for local rules that may affect you.

Remember that the language you use in your recruitment materials must comply with EEOC guidelines. For example, to avoid discriminating against older job candidates, nix words like *young*, *recent graduate*, *boy*, or *girl*. Your message makes all the difference

Conducting Interviews

When interviewing candidates, a franchisee is not only representing the brand but also making an important investment decision. If the interviewee becomes an employee, the franchisee will want that person to understand their passion for the business and the way they expect the employee to perform. Even if a candidate doesn't join the franchisee's team, they can still talk about the franchisee and its operations from an insider's viewpoint.



REMEMBER

Candidates can influence others — both potential employees and potential customers.

An interview presents the perfect opportunity to discover the human being whose name tops a résumé or job application, which is a challenging process. Many of today's job candidates are very well polished, including those who have been coached by outplacement firms or how-to books. A franchisee's job is to understand the position to be filled, ask fair questions, maintain control of the interview, and project a sense of confidence. A franchisee may want to ask for general guidance regarding best practices from other franchisees or from an independent human resource consulting firm. Unfortunately, because of the actions of the NLRB and DOL in advancing their new joint-employment standard, many franchisors are no longer able or willing to provide you with this basic and beneficial information as they might have been in the past.

As you approach the interview process, remember that you need to *select* — not just hire. You want the *best* candidate for the job. Having just any warm body filling a position places your investment in jeopardy. Invest the necessary time and money to put together a team of employees who take your investment seriously.

Before you interview a candidate, make sure you do the following:

- » **Have the right tools.** These tools may include the following:
 - **A prototype application form:** If a sample form is included in your operations manual, modify it for your own use and for your own company and photocopy a big stack.
 - **Information about your franchise and the brand:** Give this information to the prospective employee. Many franchisors produce information brochures that you modify for this purpose. You should make certain that applicants know they're joining your company and don't think they're going to work for the franchisor.
 - **A document listing the questions you want to ask:** The purpose of an interview is to get the information you need, and the best way to do that is to know in advance what you want to ask.
 - **The rules of employment:** If you're going to offer the candidate a job, provide her with the rules that you may include in your employee handbook.
- » **Know the days and hours you have available or want the candidate to work.**

- » **Review the candidate's application.** Look at all the answers, placing the greatest emphasis on dates of employment, reasons for leaving, salary history, positions held, and references. Review the applicant's work availability and decide whether it matches your scheduling needs. You will have time before you make the job offer to verify all the information. During the initial interview, simply accept the answers as facts that you can use to ask probing questions.

Asking the right questions

Running a business is like being onstage, and you are the stage manager. You control the environment. During the interview process, remember the following guidelines:

- » **Set the tone for the interview.** Conduct the interview in a quiet location with limited disturbances. Your goal is to establish rapport with the applicant so that you can gather information to guide you in making your decision. Always give candidates your undivided attention. They deserve this courtesy. Job seekers are eager to please and may give you answers they think you want to hear, but you can avoid feeding them answers if you ask your questions first.
- » **Introduce yourself and explain your function within the business.** Always refer to “we” rather than “I” to instill a sense of belonging. Making sure that candidates know “we” includes them if they join your team makes them feel that they're joining an inclusive organization that cares about them, the team, and their work environment.
- » **Make sure all your questions are specifically job related and appropriate.** Consider the value of each question and ask questions accordingly. Base hiring decisions strictly on the requirements of the job and the behavior and personality necessary to perform it — according to your standards, of course.

During an interview, don't ask questions that the law forbids you to ask. If you're not sure whether you're crossing the line, double-check with your attorney, your local department of labor, or your state attorney general's office.
- » **Ask open-ended questions whenever possible.** Open-ended questions are ones that interviewees can't answer with a simple yes or no. These kinds of questions encourage the candidate to talk and provide a basis for interaction, expressing their ideas, goals, values, and feelings. An interview featuring primarily open-ended questions is livelier than an interview that goes from one staged question to the next. Open-ended questions usually begin with

action words, such as *why, who, where, how, in what way, describe, tell me about*, and so on. For example:

- Tell me about yourself.
- Describe what you liked most about your last job.
- In what way would you provide great customer service?

Often, candidates will tell you about their families and their hobbies. This information offers hints about what excites and motivates them and whether they would be happier, say, behind a desk or out on sales calls. Reading between the lines can give you a sense of their interpersonal skills, strengths and weaknesses, and willingness to be team players.

If the candidate tells you that they didn't learn anything on their last job and that their supervisor was constantly on their back for not coming in on time, you have to look further to see whether the candidate understands the meaning of working as part of a team. If the candidate thinks that petty theft is okay, do you think you can trust them? Look past the surface answer and probe until you get an understanding of who the person is and how well they would fit into your team.

» **Avoid closed-ended questions, except to gather factual and objective information.** Closed-ended questions provide specific information about such things as skills and experience. For example:

- What was your title in your previous position?
- Did you graduate from high school?
- Do you have a driver's license?

» **Determine the applicant's wish list.** Figure out what they want in terms of position, shift, part-time or full-time work, pay, and opportunities for advancement. Do the applicant's needs concerning pay and hours match your needs? If not, the applicant probably won't take the job. If they do, they'll be unhappy.

» **Ask about availability.** Often, class schedules, second jobs, a spouse's or partner's job schedule, or child care affect an applicant's availability, so asking about it may identify a candidate suitable for split shifts or part-time hours, which can reduce your payroll costs. (Make sure, though, that your questions don't violate EEOC guidelines.)

» **Assess the applicant's demeanor.** Pay attention to appearance, attitude, character, and desire for the job.

» **Determine the applicant's potential.** What is the candidate's education background? Has the person had a career that shows progression in responsibility? Do the applicant's speaking ability and demeanor command respect? The answers to these questions can identify traits you should be looking for.

» **Make a decision.** Either continue or close the interview.

Continuing an interview

After you've covered your preliminary questions, if you decide to continue with the interview, your next step is to run through all the details of what you're looking for in the ideal candidate so that the candidate can make a decision:

- » **Provide the candidate with a complete job description.** Include duties, available shifts, hourly wages, benefits, training, and so on.
- » **Let the candidate know your policies and expectations.**
- » **Discuss your dress code and grooming requirements.**
- » **Let the candidate know your scheduling requirements.** What shift will they be on? When they need to be at work? Do they need to be on call? Do you need to tell them times of the year when they can't have vacation or time off because it's your busy season?
- » **Stress that the atmosphere is one of teamwork and why this is important.**



TIP

If an applicant is worth considering, they will have questions. Respond to these honestly. The candidate needs to make an important decision and, just like you, wants to have all the relevant facts. Allowing the candidate to ask questions may open up a line of thought you hadn't considered before. By making sure that a candidate understands what's what, you reduce the risk of turnover due to misunderstandings and unrealistic expectations.

Doing background checks and other post-interview diligence

After you find a qualified applicant, check their references — personal and business — before you make an offer the applicant can't refuse. Background checks go beyond job skills to reveal other qualities. Is the applicant conscientious? Do they have integrity? Are they arrogant? Are they a perfectionist? Obviously, some people will get cut. You may, however, want to keep their applications on file for a year in case a job opens up that fits their skills.

As a franchisee, you represent your company in everything you do. Just because some candidates don't fit your needs today or you don't fit theirs doesn't mean you have to part as enemies. Candidates may have friends who need a job and fit your requirements better. They may know co-workers at their current jobs who are perfect for your opportunity. They may love your product or service and tell their family and friends. Even in a job interview, you represent your brand.



REMEMBER

It's important that the candidate understands who they will be working for. Surprisingly, some staff may think they're going to be working for the franchisor because that's the name on your front door. Let them know up front that they work for you and spend some time explaining to them something about the franchisor and franchisee relationship. This may be the first time they have ever worked for a franchisee.

Retaining Good Employees with a Good Work Environment

After hiring and training your employees, you have to figure out ways to make sure they will stick with you. A paycheck alone is not good enough. You have to motivate and offer incentives. Everyone appreciates a pat on the back.

The best approach is for a franchisee to make recognizing their employees a priority — throughout the day, not just at the end of the day. You have to delegate. You have to empower. You have to give respect. You have to relate well. Express your expectations to employees and communicate with them via such methods as rap sessions, anonymous employee surveys, and information — positive only, please — posted on bulletin boards.

One of the greatest motivators is making employees feel that they contribute to the franchise. If they don't feel respected, they'll leave no matter what you pay them. Are you giving people responsibility? Do you recognize and reward good deeds? Do you bounce ideas off employees? Do you let them mentor newer employees? Do you encourage them to voice complaints?

Employees also get energized if you offer them some diversity in their responsibilities. That is a big reason to include cross-training in your training program. If employees feel skilled and confident at their tasks, they'll be more likely to stay on.

Here are some other tips on keeping good employees:

- » **Rotate boring and routine jobs.** Job rotation will keep the staff fresh.
- » **Be fair.** Don't show favoritism. Nothing is worse for morale than a boss who isn't fair.
- » **Allow staff input in developing the schedule.** Give your employees some say in making the schedule. If employees informed you of hours they couldn't work back when you hired them, make sure that you don't pressure them to

work those hours after they're on the job. If you have more hours available, and employees want them, give them the additional hours.

If employees attend school, see if a split shift is better for them. (A *split shift* is when an employee comes to work for a few hours, leaves, and then comes back later to finish the day.)

- » **Post the schedule.** Whenever possible, do it at least two weeks in advance. Let employees plan their personal lives.
- » **Treat your employees with respect.** Don't allow any employee to be disrespectful to any other employee.
- » **Keep employees informed.** Let them know, for example, when you're beginning a new marketing campaign or other promotions.
- » **Remove the hassles of the day.** Ask employees which procedures are working for them and which aren't. If possible, change the conditions that are making them miserable.
- » **Make their workdays challenging.** But also make the work fun.
- » **Provide performance reviews.** Make sure they're timely and frequent and give wage or salary increases.

Obviously, even with your best efforts at retention, you'll probably have some turnover; someone may move or become a stay-at-home parent. Or misconduct, customer complaints, or poor job performance may be so severe that, despite warnings, you will have to let an employee go. Even if you have a great staff and your turnover has been low, maintain a strong staff-recruiting program. You never know when you may need it.

Fostering a good work environment

Franchisees always talk about making customers happy — which is absolutely a top priority. But if your employees aren't happy, how can your customers be happy? A big step toward employee satisfaction comes from creating a good workplace environment. You can't create a good environment by simply plastering smiley-face stickers on every wall — you have to concentrate on those aspects of your operation that make employees feel they're being treated fairly and safely.

To create this feeling among employees, you have to do four things:

- » Establish and enforce policies on antidiscrimination compliance, including those related to the gender and sexual orientation of all of your staff.
- » Make certain you have a work environment that's inclusive to all your team and don't allow small tensions between staff to build into major problems. If

you set the right tone as a leader, your staff will understand that you're serious about the working conditions for your business.

- » Encourage employees to speak up about any of their concerns on these issues.
- » Set a pay rate that's competitive and reward your staff on a regular basis as they deserve it. It's far easier and cheaper to retain great employees by treating them well than continually have to recruit new workers.

Hiring good managers

A good manager is flexible enough to help out with whatever is needed in the store — lending a hand at the cash register, cleaning tables in the dining room, or greeting customers. The manager has to be very observant of what's going on — and keep the lines moving.

A good manager thinks. It's not how hard a manager works — it's the manager's ability to get other people to work hard. Are they a good motivator? Do they know the employees? You need the right person at the counter. You have to cross-train, of course, but you will still have some people who are better at certain tasks than others — at making sandwiches, for example. You have to be very fast to do that, and only certain people are good at it. The manager really has to say, “Okay, this person is best and happy at this job.” That is part of management — you have got to know your people.

Thinning the herd: When terminations need to be done

Despite a franchisee's best efforts to attract, train, and motivate high-quality employees, sometimes an employee just doesn't work out. Be sure to comply with your legal responsibilities and be consistent with your own employee policies when disciplining and terminating employees. Don't fire an employee for a reason the law forbids — or for an action you allow other members of the staff to get away with. A franchisee should consult with their attorney, local department of labor, or state attorney general's office if unclear about whether an employee can be legally fired (or about any obligations following termination). Although you should ask other franchisees how they handle their human resource issues, don't expect your franchisor to provide you with any guidance in this area.

COMPLYING WITH THE ACA AND LABOR LAWS

It's the franchisee's responsibility to comply with applicable laws regarding employees' wages, hours, and benefits. State and federal laws set the minimum wage for where the business is located. The U.S. Department of Labor recently implemented a new overtime regulation that increases the number of workers (mostly managers) who qualify for overtime. Under the Affordable Care Act, a business must offer health insurance coverage for all workers who are on the job at least 30 hours per week or pay a financial penalty.

Such regulations may impact how many workers a franchisee can hire or how it schedules employees. A franchisee should consult with their attorney regarding the laws and regulations that govern the pay and benefits that must be provided to the franchisee's employees. Recently, the International Franchise Association (IFA) started to provide an Overtime Compliance Tool designed to help franchisees meet the requirements of the new overtime regulation. You can find information about this worthwhile tool at <http://labor.franchise.org/ottool>.

Ensuring workplace safety

The franchisee runs their locations and controls their staff. Safety and security are the franchisee's responsibility, not the franchisor's. Smart franchisors, however, provide their franchisees with reams and reams of paper on recommendations for safety and security. A franchisee should look for this kind of commitment. A franchisee also should review the Occupational Safety and Health Act, administered by the Department of Labor's Occupational Safety and Health Administration (OSHA). The act regulates safety and health conditions and may require employers to adopt certain practices to protect workers. All this material may be tedious to read through, but it's worth any business owner's time. Preventing mishaps directly corresponds to employee and customer retention — and profitability.

Safety concerns vary by business, of course. But some safety issues are pretty standard, such as properly using the equipment, correctly handling materials, knowing where to store fire extinguishers, and preventing burns, falls, and other accidents. Nobody wants to see an employee or customer fall on a sidewalk that should have been cleared of ice. A franchisee and their staff should have certain procedures down to an exact science — for example, how often to clean the bathrooms and mop the floors and how to lift heavy objects. In the restaurant business especially, food handling, storage procedures, and cleanliness are major priorities for safety and health reasons. All franchisees want to have happy employees, but no one will be happy working hard and long in a dirty place.



REMEMBER

Regardless of whether the franchisor gives sample guidelines, and regardless of whether it includes comments about safety and security on its field reports to franchisees, operating the franchise in a safe and secure manner is the *franchisee's* responsibility, not the franchisor's.

As an employer, you could face a wide range of problems, from employee theft to armed robberies. Find out what the franchisor, other franchisees, and local merchants recommend in terms of alarm systems, closed-circuit TV systems, and door controls. Check with local experts and the police on what you can and should do to make your location safe. Safety and security are your responsibility to your customers, vendors, and staff.

Also, carefully check out employees' backgrounds — to the extent that you are legally able to. Then train your employees to be on high alert. For example, instruct office or store managers to call the police immediately if they see a crime in progress or someone disturbing customers or employees. Educate employees in simple security precautions; for example, advise them to leave a restaurant after dark only if accompanied by another worker. Check out www.safetawakenings.com/SAFETY-RESOURCES-FOR-RETAIL-OPERATIONS/ for additional information.

We know this advice sounds like common sense. Still, you need to have security precautions in place and procedures for reporting all crimes.

- » Following the franchise rules
- » Establishing a relationship with your franchisor
- » Coping with change
- » Building relationships with fellow franchisees

Chapter **10**

Working with Franchisors and Fellow Franchisees

This chapter, perhaps more than any other, talks about people and the relationships you will be establishing and relying upon in franchising. The franchisor will be establishing the brand standards for your business and will be giving you plenty of direction and advice on how your business should be operated. It will also send field consultants to look over your shoulder to ensure that you are consistently meeting those standards.

In most established franchise systems, there are lots and lots of people making up the franchise team you have joined, including franchisor personnel and also other franchisees. You'll need to understand how to deal with each of them and know what to expect from them and what *not* to expect from them. This chapter talks about the best ways of doing that.

Playing by the Rules

By signing a franchise agreement, franchisors and franchisees begin a relationship based on mutual trust and confidence. The other franchisees in the system

will also be relying on you as well, because how well you perform has a direct impact on them and their businesses.



REMEMBER

Because of the rise of customer reviews, written on Twitter and review sites like Yelp, Google, and Trip Advisor, what happens in London no longer just impacts Manchester and Oxford — it also impacts San Diego and Miami. We live in an ever-shrinking world. Everybody wants you and your business to succeed. If you follow the franchisor's system you just might do that, but for certain, if you don't, your operation is likely going to suffer and possibly even fail. Your failure won't only impact you, it will also impact the other franchisees in the system. So remember: The whole team is counting on you to play by the rules.

Meeting franchise system standards

Franchising has an interesting dynamic missing from most other types of expansion strategies. The owner of the brand and the operating systems has little to no control over how the business is managed and operated on a day-to-day basis. That is the responsibility of the franchisees.

Most franchisors trust that the franchisees will operate the businesses with pride in the system and rely on the franchisees to independently manage the business in a way that consistently delivers to every consumer the brand promise of the system. Franchisors drill and drill their franchisees on system standards to ensure that they understand what the system's brand means to consumers. Franchisors do so when first meeting franchisees during discovery day, at training sessions, during franchisee meetings, in the operations manual, in franchise newsletters, in webinars, through the system's field consultants, and every other chance they get. Franchisors celebrate publicly those who execute the standards well and may expel from the system those who don't. And in all cases, franchisors constantly emphasize the importance of brand standards in an effort to maintain the value of the brand, support the pride everyone has in it, and ensure that the consumer can rely on the franchise system's brand promise.

Maintaining a system everyone can be proud of requires that everyone meet the system's brand standards — at every franchisee operation and at every company-owned operation.

"Selecting franchisees that can independently deliver to the high brand promise of a home care brand like BrightStar Care is what has allowed us to grow and today lead in our industry segment," says Shelly Sun, founder of BrightStar Care and chair of the International Franchise Association. "During our discovery days we are not selling the prospective franchisee on the BrightStar Care system. Instead they are selling us on why we should trust them to operate in their local markets using our brand. After all, while we license our system to franchisees, and they share a brand with all of the other franchisees in our system, it is our franchisees that are

going to be the ones solely responsible for delivering to BrightStar Care’s high brand standards. I have grown BrightStar Care with a personal commitment that while I am not with every patient every day, our selection, training, accreditation requirements and support of our franchisees is to give our patients and their families the confidence required in selecting BrightStar Care to care for their needs.”



WARNING

As powerful as the brand promise can be in achieving success, *not* achieving the goal of brand standards consistently can be a franchise system’s greatest risk and threat. It only takes one franchisee who doesn’t “get it” to cause significant damage to how the public perceives the entire system. In the age of the Internet and social media, nothing is local anymore. Every violation of brand standards that negatively impacts any customer experience can potentially become a system-wide problem. Because of that, franchisors and franchisees take brand standard violations very seriously.

Franchising isn’t perfect. Great franchise systems are simply careful and corrective. It is expected in a franchise system that when problems occur at a location, a good franchisee will take immediate and independent action to fix the problem before anyone becomes aware that anything bad even took place. When there is a dirty bathroom or a lack of proper fizz in the soda, good franchisees correct the problem instantly, because such things are important to how the public views the entire system.

When problems aren’t fixed, or they repeat and continue, that’s when franchisors generally step in to address how to bring the franchisee’s business back into compliance. Franchisors do so because meeting brand standards is important — not just to the franchisee’s business, but to everyone that shares the brand with them.

How does this work? Most of the time (unless the violation is creating a public hazard or is considered extreme), the franchisor’s *field consultant* contacts the franchisee and works with them to understand the brand standard and fix the situation. In mature franchise systems, the role of the franchisor’s field consultant is primarily to provide the franchisee with coaching to help improve the business and bottom-line performance. Although good field consultants don’t see their job as primarily a policeman for the brand, in a sense they are. An important part of their job is brand integrity, and therefore enforcing standards and assisting franchisees to return to operating standards generally is their responsibility, because they’re the ones visiting the franchisee’s business location.

If problems are severe or repetitive, franchisors usually beef up their oversight of the franchisee’s location to ensure that the franchisee makes the necessary corrections and monitor the situation going forward to make sure the violations don’t reoccur. If violations do continue, franchisors can invoke the remedies available in the franchise agreement, which can include notices of default with a period of time to cure, and ultimately termination of the relationship. However, nobody benefits when it becomes necessary for a franchise contract to be terminated, and although the franchise agreement will contain this right, termination is not that common for many reasons.

Supporting and watching the system

The *field staff* are a franchisor's front-line troops and are the real troubleshooters in franchising. They are the members of the franchisor's staff who work directly with franchisees.

The field staff may go by many names, including field representatives, field consultants, or regional managers. Of the various names franchisors use to describe their field staff, for most brands *field consultant* is the most accurate because the major role of the field staff is to act as a consultant to the franchisee. A field consultant's primary job should be to help franchisees improve the performance of their operations. Field consultants stay in regular contact with franchisees by phone, e-mail, and in person to identify problems, answer questions, and bring solutions and ideas directly to the franchisee.

In some systems, field consultants are also involved in local training, but more and more today they work with the franchisee's internal trainers to help them better train their own staff independently. Field consultants aren't the same as general managers and have no role in the franchisee's management or day-to-day control over their business — including the franchisee's human resource policies.

Field consultants and franchisees must develop a relationship of mutual confidence and respect in order to maintain a positive working relationship. The field consultant's job is to work with the franchisee to assist them in improving their businesses. They conduct regular inspections of the franchisee's location, discuss any deficiencies, and make recommendations on changes that may be needed. The job of the field consultant — in good systems — is to help franchisees increase the equity they have in their businesses by working with them to continually improve their performance. This includes addressing situations when the franchisor's standards aren't being met, for example, if the staff is not in uniform or the merchandise displays are empty or dirty, and also evaluating financial performance.

Not all the work done by field consultants is in person. With the availability of a host of communication tools today, much of the support many franchisees get is conducted electronically. But in most franchise systems, field visits are relatively frequent.

The timing of the visits may be scheduled or unscheduled. In some systems the timing of visits varies depending on a host of factors that may include social media reviews or the franchisor's analysis of the franchisee's financial and operational indicators. In mature systems, the franchisor obtains this information from monitoring Yelp and other review sites or through reports and other information that the franchisee routinely provides, usually electronically and often through an online point of sale (POS) system.

In other franchise systems, field visits are few and far between, and support is not routinely provided by the franchisor. That level of support may be perfectly in line with the promises made by the franchisor and agreed to in the franchise agreement.

The Web and social media

Social media is make-or-break for brands today. It's an effective tool, especially for franchisors that aren't in day-to-day contact with franchisees.

To a great extent social media has replaced customer comment cards and has done it in a way that is instantaneous. Consumers of all ages are aware of these social media sites, and many regularly leave reviews — both positive and negative. Using social media in this way is more the norm than the exception today. There are few good businesses, including franchisors, that don't regularly monitor Yelp and other Internet review sites for comments about their businesses. In addition to the franchisor and consumers who regularly review these sites, other franchisees in the system do also. Social media also alerts the field consultants and others in the franchisor's organization when problems arise so that effective action can be taken.

Mystery shoppers

Mystery shoppers are usually employees of companies that specialize in shopping a chain's locations and reporting back to the company what the customer experience is really like. To ensure that the mystery shopper provides the information the franchisor wants to learn, the franchisor develops a checklist about the aspects of the shopping experience it wants to focus on and trains the mystery shopping company on how the brand experience should be delivered. Mystery shoppers are used in many industries, from restaurants and retailers to carpet cleaners, hair salons, gas stations, auto repair shops, and just about every other segment of franchising. But because of social media and other problems inherent in these snapshot reviews, fewer franchisors are using mystery shoppers today than in the past.

Your customers

Good franchisors take customer comments — whether delivered through social media, comment cards, or a toll free number — very seriously. When comment cards or any information about a franchisee's location comes to the franchisor, if the franchisor responds, it usually just lets the consumer know that the comment has been received and the franchisor has forwarded it to the franchisee. Franchisors don't generally solve the problem directly, because it's the responsibility of the franchisee as the owner and operator of the franchised business, and not the franchisor, to deal with local issues as they arise. The franchisor expects the franchisee to deal with customer complaints directly, and when that fails to occur, there are generally tools available in well-designed franchise systems for the franchisor to effect corrective actions.

Fellow franchisees

The other franchisees in a franchise system can also be the eyes and ears of the system. It is expected that franchisees will shop their fellow franchisees and when concerns about how a franchisee is operating the business arise, the other franchisee will often discuss this directly with the franchisee and with the franchisor. This makes sense because one bad performer can harm the brand and therefore the other franchisees' business.



TIP

Franchisees don't think they're interfering in someone else's business. Each unit is part of the whole; they are just protecting their own equity interests. Some of the most effective advisors a franchisee can have are the more experienced franchisees in a system. In a way, those experienced franchisees become part of the franchisor's support team. The reason is quite simple: From whom would it be better to get advice than a peer who understands the reality of day-to-day operations, has been through the exact same problems with the exact same brand, and from experience knows the tricks?

Success and failure of any business are generally tied to how well the local operator performs. It's the franchisee's responsibility to do a self-audit of operations. It's a good idea for franchisees to periodically review the operations manual and training materials they've received to ensure that their business is up to snuff. When they need help, it's their responsibility to ask for it from their franchisor as well as from other franchisees. The franchisor may not know that a problem exists unless the franchisee brings it up.

All knowledge and assistance doesn't flow from the franchisor's well. The franchisor is licensing the franchisees a system — not operating the business for them. In addition to seeking assistance from the franchisor and other franchisees, a franchisee should seek professional outside advice when it is required. For example, local accountants can help improve the recordkeeping, which helps get a better handle on the business, and local marketing experts can help create cross-merchandising opportunities with other merchants (subject to a franchise system's standards) and help develop ways to target new customers. Franchisees should attend management classes at the local university and send their management team to classes too — that team is running the show when the franchisee isn't there.



REMEMBER

The responsibility for execution excellence is that of the franchisee and not the responsibility of the franchisor.

Attempting to change the system

There are no successful businesses that don't evolve. Consider how different McDonald's is today in look and product offering from where it was in 1955. Although many of the changes we see taking place in franchised brands comes

from the franchisor, ideally, every system should also encourage ideas from franchisees. After all, franchisees are the ones on the front lines, and they may see ways to tweak the system. Most franchise agreements contain provisions addressing how a franchisee can propose changes, including new products and services, alternative suppliers, marketing approaches, and the like. If a franchisee has an idea to improve the system, he or she should always propose it. The franchisor may not adopt every change — in fact, it may only adopt a few. But it's important for the franchisees to have a role in advancing the system by making recommendations they believe will improve the system's overall performance.

Franchisees have a much better chance of having their proposed change accepted if the new idea improves the system, fortifies the brand, doesn't infringe on uniformity, and enhances a franchisee's profitability. Franchisees also improve their chances for success if they present their proposal in a professional manner and garner the support of other franchisees and their field consultant before approaching the franchisor. Some franchisors have new product committees as a subset of their franchisee advisory council (FAC). Franchisees should talk to members of the FAC and the franchisor's management team to determine what criteria are used for recommending approval of new products and services.

Franchisees with a great idea should speak up. But don't be insulted if the franchisor says no. A franchisor has to look at the overall system and determine how it serves the customer. The great idea may not fit in the overall scheme of things. Good franchisors are open to ideas, but the franchisor's job is to make the hard decisions — and sometimes the decision is no.



WARNING

Franchisees should be wary of franchisors who approve all suggestions willy-nilly, especially those that compromise product lines and quality standards. That lack of discretion is evidence of a weak system and can destroy the basic concept a franchisee is buying into. In the vast majority of franchise systems and franchise agreements, if a franchisee's idea is approved, the improvement is the franchisor's property, and the franchisor reserves the right to use it and make it part of the franchise system — without paying the franchisee any compensation.

Building a Relationship with Your Franchisor

In franchising, as in any relationship, franchisees are bound to have ups and downs. The key is to be part of a system in which the seesaw tips toward the higher end.

Without a doubt, there can be a love-hate relationship between the franchisee and the franchisor in some franchise systems. It can be very confrontational, and disputes are sometimes substantial and involve litigation.



TIP

In evaluating a franchise opportunity, prospective franchisees should check out any past or present litigation involving the franchisor. The franchisor is required to disclose certain litigation history in Item 3 of the franchise disclosure document (FDD — see Chapter 4 for more). If the franchisor has been involved in a number of lawsuits, research the lawsuits listed before you buy into that franchise system. One of the roles your legal advisor can play for you is evaluating the cases in which the franchisor has been involved and give you guidance on whether it is an indication of a strong franchisor that is protecting the brand, a weak management team that manages the system through litigation, or franchisees who have real problems with the relationship with the franchisor.

Being a team player

When a franchisee signs a franchise agreement, the parties are committing to a long-term relationship. The franchisee is promising to uphold his or her end of the bargain (pay royalties, abide by the operations manual, and so on), and the franchisor is promising to meet certain obligations (support services, brand identity, and so on). That is the relationship drawn on paper by the lawyers. The contract is long and detailed and contains representations and acknowledgements that both parties are agreeing to and that both parties have the right to rely upon.

The relationship begins from the very first moment a franchisee meets the franchisor and continues through initial training, the grand opening, field consultant visits, phone calls, e-mails, newsletters, continuing training, updates to the operations manuals, and annual meetings. Communication is a very important component of this relationship and it is a two-way street. Taking part in communication keeps franchisees and franchisors current on each other's businesses, keeps the relationship fresh and open, and helps evolve the system and keep it moving forward.

Although legally the relationship is based on the contract that the franchisor and franchisee sign, how the relationship actually performs is based on mutual trust and respect. Often the relationship grows into a friendship. A franchise relationship is a long one, and working with people you like is always a good situation.

Being a *team player* usually tops franchisors' most-wanted list of franchisee traits, because they want you to be willing to abide by the premise of the ongoing franchise relationship. That's why veterans are in such demand in franchising today — they understand discipline, how to execute a predetermined strategy, and most assuredly know that they can use their personal skills to outperform the plan.

The franchisor is the coach — the designer of the plays, the person responsible for the whole team. The franchisee is the superstar — the one who makes all the plays work, the person whom the rest of the franchise team relies on to perform well. This basic relationship, in which everyone depends on everyone else, doesn't change even as the franchisee matures in the franchise system. An added bonus to franchisors is that the great-performing franchisees are the models that all of the other franchisees want to emulate.

Even though a franchisee is a superstar, that doesn't give them the right to make changes to the system without the franchisor's permission. Also, even though the franchisee will receive support from the franchisor, being a superstar, they're not solely reliant on that support. After all, the franchisor isn't managing the business or even directing the franchisee on how to manage the business. It's merely licensing to the franchisee a system and providing them with guidance and support. Whether the business is a success or a failure is the responsibility of the franchisee and not the franchisor. This is important to understand. "If every prospective franchisee fully understood Michael and Joyce's description of the roles of the two parties to a franchise agreement, there would be far less conflict and more positive focus on what it takes to be a successful franchisee," says Jeffrey Tews, a 10-year franchisee with BrightStar Care.

Getting what you need from the relationship

Franchising is not a fee-for-services relationship, and it's important for franchisees to remember what they're paying for with their royalty payments. What a franchisee is getting for the initial fee is the right to join the system, and the continuing royalties are for the continuing right to use the franchisor's trade name and membership in the system, so long as the franchisee remains in compliance with the system.

Your contract with the franchisor will define what services you will contractually receive — and in most great systems the franchisor does more, just as most great franchisees execute better than others. The franchisor's ultimate success is tied to the franchisees. The services provided by the franchisor support the franchisees so they can stay in the system and succeed, thereby benefiting the franchisor.

As franchisees mature in a franchise system, their need for support changes. Just as experienced multi-unit franchisees need a different level of support than single-unit franchisees, the level of handholding a franchisee needs in year five is less than required in year one.

What won't change is that, every week or every month, franchisees pay royalties to their franchisor. And as sales go up, usually so does the size of the payment. Although some franchisors' royalty schemes make adjustments with lower

royalty rates for franchisees with higher sales or multiple locations, most don't, and this sometimes is a formula for dissatisfaction for some franchisees. After all, if a franchisee needs less support as he or she matures in the system, why should the payment be larger? Some franchisees may even ask, "What has the franchisor done for me lately?"

The hard answer is that the fees paid to the franchisor generally allow for the use of the franchisor's brand name and marks and access to the operating system, as provided for in the franchise agreement. Unless and only to the extent that the agreement provides for field support or other services, the franchisee may not be entitled to receive more services. The answer to the question "what has the franchisor done for me lately" is answered simply — it has allowed the franchisee to continue using its brand and operating systems per the franchise agreement. Under many agreements, that's the bargain agreed to, and that's what the franchisee is paying for.

In evaluating a franchisor, ask some basic questions:

- » Is the franchisor growing and creating critical mass in the markets in which it is entering?
- » Is the franchisor's staff doing research and development into new products and services?
- » Is the franchisor working on new ad campaigns?
- » Is the franchisor ahead of the technology curve to keep franchisees competitive?
- » Is the franchisor looking for ways to reduce costs — including labor costs — by adopting new methods and solutions?
- » Is the franchisor examining opportunities to expand the system through e-commerce?
- » Could the franchisor turn on a dime in response to changing customer demands and market conditions?
- » Does the franchisor have an active franchisee advisory committee, empowered to help improve the business and look at new opportunities?
- » Are franchisees involved in strategic planning for the franchisor?
- » Does the franchisor subscribe to the International Franchise Association's Code of Ethics and its Statement of Guiding Principles (found at www.franchise.org)?

The following sections discuss a few support services that most franchisors typically provide.

Research and development

Great franchisors stay one step ahead of the competition. Key functions of a good research and development (R&D) department are to understand changes in the market, see opportunities for new products and services the franchisee can sell to the public, and introduce those new products and services to the marketplace in a way that benefits both the consumer and the franchisee's bottom line.

Most franchisors use their company-owned stores as test locations before they try out new products or methods at franchise locations. Others, working with their franchisee advisory councils, also test new products and procedures with their top-performing franchisees. In launching new products or services, and when retiring other products and services, good franchisors typically go through an elaborate process that includes the following:

- » Gathering consumer research
- » Examining other industries and competitors for ideas for new products and services or other uses for existing products and services
- » Seeking franchisee input
- » Lining up suppliers needed for the new product or service
- » Testing products or services in test facilities to determine ease of preparation or assembly, ability to achieve consistency, time required to deliver the product or service, and so on
- » Determining what existing equipment or technology will be used and what new equipment will be needed
- » Developing training materials on the new product or service
- » Determining inventory requirements
- » Planning advertising and promotions
- » Verifying economic viability and return on investment
- » Testing in company-owned or franchisee-run facilities
- » Having a measured launch in different markets to see how the public accepts the new product or service and to determine whether any regional modifications will be required

All that is done before a new product or service is launched. Even great franchises begin to lose market share when the public gets tired of their products, their look, or their services — or when the public just wants something new. A current example is found in the *quick service restaurant* (QSR) burger market as new and better burger concepts enter the fray with offerings more attractive to consumers.

Office support

We're in a period of change in franchising — primarily due to the actions of the National Labor Relations Board (NLRB) and the Department of Labor (DOL), which have been on a crusade of late to support labor unions in their organizing efforts. A major change by the NLRB and DOL has been to re-define the relationship between the franchisor and franchisee as *joint employers*. (See Chapter 9 for more on this.) Under a joint-employer relationship franchisors would be responsible for some of the actions of the franchisee — including how they manage their human resource practices.

Because of the re-definition of joint employment, many franchisors that previously provided beneficial office support to franchisees are slowly eliminating many of those beneficial services. It is likely that you will find that some of the services franchisors currently offer will be reduced or eliminated. If that happens, it will be unfortunate for both the franchisee and the franchise system as a whole. You should discuss with your franchisor if it's planning on reducing any of the support services you're counting on.

Fees for services

Although some franchisors have offered certain services for an additional fee, many modern franchisors have moved away from offering an a la carte-type support system where the franchisee pays for services as it goes. There are several reasons for this change. The main reason is that often the franchisee that most needs the additional service, such as additional field support, may not be willing or able to pay for it. The franchisee then suffers, as does the franchise system overall.

Any fees for services performed by the franchisor will be listed in Items 5 and 6 of the franchise disclosure document (FDD — see Chapter 4). Prospective franchisees should review the fees charged and ask existing franchisees about fees and the benefit of that support in their due diligence. Don't assume that all types of support are included in your royalty payments. Some of the fees for services commonly found include training of managers and employees, reservation systems (for hotel or car-rental franchises), proprietary software, marketing, and special field support.

At times, you may think that the franchisor should offer you more support. You might even expect additional service because the franchise salesperson told you that you would receive it. And it may have been the practice of the franchisor in the past to provide those services — even though it had no obligation to do so under the franchise agreement.



REMEMBER

A franchisor's policies may change, but the franchise agreement reflects the terms of the bargain you both agreed upon.

The franchise agreement is the key to understanding the obligations of the franchisor and the franchisee. Just because one party to the bargain wants more services, or doesn't live up to the contract, the other party is not necessarily obligated to perform those additional services — or ignore the other party's contractual requirements. If you're getting more services from your franchisor than what the agreement requires, say thank you. Such support shows that your franchisor cares. In a great relationship, the franchisee will also exceed what the franchise agreement requires. The street goes both ways.

Dealing with Change

Time for a wake-up call. Does everything with your franchisor seem same old, same old? Or has something changed while you were snoozing? Just as people pass from infancy to adolescence to adulthood to old age, franchises go through stages, too. These phases can greatly affect the franchisee-franchisor relationship — for better or worse.



REMEMBER

Changes in a company's growth, financial state, support staff, and even competition all can contribute to subtle or blatant swings in support services, communication, operating requirements, and other aspects of the relationship. If your franchise system isn't always looking for ways to change and improve, it won't be long before the competitive advantages you were looking for at first will be gone.

When the franchise system changes

Consider this: A franchisor adds more and more units nationally and internationally. Since the beginning of your relationship, your field consultant has visited your retail store each month, spending four to six hours with you, going over marketing, operations, scheduling, and other important matters. Then your field consultant is assigned the added responsibility of overseeing the development and support of locations in a country with a name you can't even pronounce. The consultant visits you quarterly now, rather than monthly, and spends only 30 to 40 minutes with you before rushing off to another franchisee. Your support from the franchisor has declined.

Here's another example — same franchisee, same system: Instead of going international, the franchisor begins franchising another product or diverts attention to the development of an e-commerce business or buys or starts another franchise system. The franchisor uses the training, operations, and field personnel from your franchise system to support the development of the new product or the new franchise system. Same results: The support you came to rely on is no longer there.

Read your franchise agreement. You probably were never promised weekly or monthly visits that lasted four to six hours; you just grew accustomed to them. Still, a reduction in the frequency and length of meeting with your field consultant is no reason to be complacent. You might even want revenue from e-commerce activities, but you likely are not legally entitled to it (see the next section, “When conflicts occur”).

Ideally, as a franchise chain grows, the size of the support organization should also grow. For example, if the optimum ratio of field consultants is 1 to every 30 franchisees in a system, and the franchisor doesn’t add a new field consultant to service new franchisees, the number of units that that field consultant is responsible for will increase, and the consultant’s ability to service each franchisee as they did in the past will decrease.

This is not always immediately an issue, though. For example, if the growth is through existing franchisees opening more units, multi-unit franchisees often need less hand-holding anyway. Also, higher density of units may mitigate this impact, as the field consultants can get from store to store more easily. Technology can also allow a field consultant to handle additional locations very effectively. Many mature franchisors use cell phones, e-mail, automated sales reporting, webinars for training, distance learning, videoconferencing, and so on to make their field consultants more efficient and effective. But as a general proposition, as the number of locations increases, franchisors should add personnel so that the ratio of field and headquarters support staff remains sufficient. That is franchising at its best.

When conflicts occur

Smart franchisors and franchisees work hard every minute of every day to forge lasting and positive relationships with each other. Franchisees need to have confidence in their franchisors, and vice versa. The recipe doesn’t get any more wholesome than this: honesty, integrity, and open communications.

Communication has to flow in both directions to work. A franchisee may have a problem and be angry that the franchisor is not helping, but does the franchisor even know that the franchisee is having a problem? If something is on a franchisee’s mind, it’s their responsibility to call the field consultant and ask for assistance. If the field consultant hasn’t taken care of the problem sufficiently after notice, then it’s up to the franchisee to call the franchisor’s regional or headquarters personnel. Franchisors may not know something is broken unless you tell them, and communicating that you have a problem now is the best way to avoid a bigger problem later.



WARNING

Imagine this scenario: Despite your best efforts, sales have been down for the past two months, and you're looking at a potential cash problem in the coming few months. You're upset and worried about meeting your financial commitments to the bank, to your suppliers, and to your franchisor. Don't wait until you have no money in the bank and are in default to ask for help. Call your franchisor and ask for advice. But don't demand that the franchisor waive your royalties simply because you have a cash problem. The franchisor didn't sign up to be your banker or your guarantor.

What franchisors can do is look at your operations, see whether they can find the problem, determine whether a quick fix may work, help you prioritize your cash flow, lend you some other support, and maybe — but not often — work with you on a temporary deferral of your royalty obligation.



TIP

If the problem is that you really can't run an effective franchise or just are unhappy with the relationship, then discussing with the franchisor how you can exit your business with the most equity you will be able to garner through a sale to another franchisee or to a new franchisee, or even the franchisor, may be the best way to solve your dilemma. When changes occur that affect you negatively, speak up. Talk to your franchisor. Find out whether the change is permanent or temporary. See whether you can work out a compromise position that satisfies both of your needs. Talk to the other franchisees who are affected. Talk to the leadership of the franchise advisory council. Often, when franchisees come together to talk to a franchisor about a problem, the franchisor and the franchisees work it out together — but sometimes they don't, and that's often when the relationship between the parties begins to experience difficulties.



TIP

Although working through the chain of command is the best way, don't be afraid to voice your concerns to a higher level if you've received less than legendary service or don't get a satisfactory response. Good franchisors need to know when their field consultants and other personnel are doing a good job and when they aren't responding or performing. Also, consider putting your serious concerns in writing. Your written communications don't need to be threatening, but a letter often helps convince your franchisor of its staff's inadequate performance. Even more effective: Call and set up a time to go to the franchisor's headquarters for a face-to-face meeting with the decision makers. There's no better way to solve problems than sitting down and talking through the issues. And, at the earliest stages, doing so without threats or the involvement of lawyers is generally the best approach.

Open communication between you and the franchisor may build your relationship and possibly avert or quash any friction. Your goal should be to resolve any disagreements in the least costly, least time-consuming, and least adversarial ways if you want to continue being a franchisee.

Disputes sometimes occur that the franchisor and franchisee can't work out. Before going to blows in a lawsuit, many franchisors require that (as provided for in the franchise agreement) franchisees first meet with them and an impartial mediator. Some franchisors, instead of going to outside mediation, set up internal mediation units that include other franchisees, and some appoint an *ombudsman* (an employee of the franchisor who is paid to be an advocate for the franchisees) to look into disputes.



TIP

The International Franchise Association (IFA) has an ombudsman program you may want to consider: www.franchise.org/self-regulation-ombudsman.

Reaching Out to Your Fellow Franchisees

Your fellow franchisees are a big part of the team, and as the newest recruit, you want to hear their take on the game, the coach, and the other players. Think of existing franchisees as the live version of an operations manual — they live and breathe the system every day, so they know what playing by the franchise system's rules is like.

Building a relationship with other franchisees goes beyond simply tapping their knowledge. They're also great sources of inspiration because they usually have already confronted the same issues you may be facing. Finding out the routines they use to drive execution excellence or how they've successfully dealt with a similar problem is not only helpful but also inspirational.

Franchisees who share a geographic area often get together to discuss common issues, including marketing, spending and costs, training, and operations concerns. Many franchisors today also have intranets with chat rooms so that franchisees can talk to each other to discuss problems and offer advice and solutions.



REMEMBER

Good franchisors encourage this type of communication. Franchisees get together to plan local promotions, create local buying cooperatives, or just update each other on what is and isn't working in their businesses. In short, other franchisees provide a valuable support network.

One way to connect is through local chapters of organizations, like the IFA, which has established a monthly networking group for franchisees, franchisors, and suppliers. These meetings, held in cities around the United States, are called *franchise business networks*. The great thing about these monthly meetings is that you get to meet franchisees and franchisors from not only your own system but from other franchise systems. They're another way to build a support network of franchisees and learn from them. Even franchisees in a different industry will face

many of the same challenges you have faced regarding staffing, retention, competition, and employee motivation. Many of the suppliers who come to the meetings can also provide you with advice. To see if a franchise business network group meets in or near your city, go to www.franchise.org/franchise-business-network.

Even if you don't make an effort to reach out to your fellow franchisees, they will find you. You will meet at regional meetings, annual conventions, franchisee advisory council or franchisee association meetings, perhaps even on the Internet, or maybe on the intranet the franchisor has set up for the system.



TIP

How do you go about getting to know other people who share your franchise name? Most franchisors will be happy to provide you with a list of your fellow franchisees. Ask for it. You should also attend your regional, area, or convention meetings, which is the easiest way to meet franchisees you may not know and a good way to see old friends again.

Joining advisory councils and associations

Franchisee advisory councils and franchisee associations (don't fret, we explain the difference shortly) give order to the franchisee universe. They are communication vehicles among franchisees, and between franchisees and franchisor. As a franchisee, you want representation. And you want a system that welcomes quality input.

Franchisee advisory councils

A *franchisee advisory council* is a committee established by the franchisor and composed of franchisee representatives. It may also have representatives from the franchisor-operated units. Its purpose is purely advisory.

Here are some of the ways a franchisor can use the advisory council:

- » To present new ideas and get feedback from franchisees before rolling them out system-wide
- » To solicit suggestions on improvements to products, services, and system support
- » To review marketing and advertising strategies
- » To discuss new technology
- » To discuss new suppliers
- » To assist the franchisor in looking at conflicts in the system

Franchisees can use the council to influence the company's direction, network with peers, and voice complaints. In a council, franchisees are heard more loudly and clearly than they're heard as individuals. Even if you don't sit on a council, you can raise your points by contacting one of the council's members, who can then speak for you.

Often, a franchisor will establish criteria on who may sit on the council. If a franchisee is in default, for example, they're usually not invited to the big table. No one should really want advice or input from someone who is not in compliance with system standards — no matter how many locations they may own and operate.

Councils often spin off other committees, such as an advertising committee that provides input into advertising decisions, a buying committee that looks at cooperatives or other joint efforts for purchasing products and services for the system, and even a technology committee to look at new software or robotics to reduce labor and improve unit performance.



TIP

When you're speaking to the franchisees of a system, ask about their views on the advisory council. What does it do in their system? Do they get reports on the council's activities? Get the name of the head of the council or the local representative and give them a call. You want to understand whether the council is well run and empowered by the franchisor to have a meaningful role in the system.

Franchisee associations

Unlike franchisee advisory councils, *franchisee associations* are usually independent organizations, made up of dues-paying franchisees that come together when no franchisee advisory council exists or if the council is not viewed as adequately promoting their interests. They may function like a council, but franchisee associations set their own rules, membership requirements, and agendas. Membership dues usually fund them, whereas the franchisor more often than not picks up the tab for its franchise advisory council.

Historically, many franchisee associations were started because of a systemic crisis. For example, the franchisor may have been on the verge of bankruptcy or introduced a radical new product, service, or standard into the system without adequate testing, a change in management may have occurred, or the franchisor may have dramatically revised the terms of its new and renewal franchise agreements. Franchisee associations have frequently also been formed on the verge of system-wide litigation.

Today, while many franchisors are leery and resist franchisee associations, other franchisors have recognized that an independent association is not a bad idea and may make a positive contribution to the system, as long as its leadership acts

responsibly and listens to the legitimate concerns of its constituency. Many of these franchisors have cautiously developed procedures to include associations as part of the process to maintain and grow their systems. In some systems, the franchisee associations are granted specific rights under the franchise agreements.

For a franchise system to have both a franchisee advisory council and an independent franchisee association is not unheard of. Moreover, the lines between a franchisee association and a franchisee advisory council aren't always clear-cut. Some groups have elements of both types of organizations.

Franchisee associations can be beneficial to both the franchisor and the franchisees. It takes work on both sides to make the relationship work. Although neither of the authors of this book is anti-lawyer (Joyce is, in fact, a very well-recognized lawyer herself, who works with franchisors, franchisees, and franchisee associations), the relationship between associations and franchisors works best when it is built on achieving results valued by both the franchisor and the association. Some lawyers — by training — can often change the dynamics ideal for a positive relationship. We guess it has something to do with their spending too much time at the bar.



TIP

There are many successful franchisee associations. The Coalition of Franchisee Associations (the CFA) is an association of franchisee associations with the mission “to bring franchisee associations together to share and exchange ideas.” It may be a good source of information if you're interested in forming or joining a franchisee association. Check out www.thecfainc.com for more information.

Being number one in a class of one

All this concern about interacting with other franchisees is well and good. But what if you are it? Maybe it's a new franchise system, and you were brave enough or smart enough to be the first. When you're the first franchisee, you don't have another franchisee to check with about a franchisor's follow-through — or anything else, for that matter. You're a pioneer and are going to need to go it alone.

Some prospective franchisees find being number one exciting, anticipating a great surge in the value of the business as the chain grows. You have reason to be cautious, however. Just because a company has a franchise disclosure document (FDD — see Chapter 4) doesn't make it qualified in a business sense to be a franchisor. Remember, all you need to be a franchisor in the United States is a compliant FDD. A franchisor doesn't need to have any operating locations, doesn't need to have any profitable operating locations, and doesn't even need any experience in the business in which it is going to be offering franchises. Not all franchise opportunities are equal, and you need to make your determination to become a franchisee based on facts, not emotions.



REMEMBER

Without the input of other franchisees, you need to scrutinize the company much more carefully, because the network you're joining — for the foreseeable future — may be just you.

If the management of the franchise system you're looking at also operates another franchise system, check out the franchisees in the other system to at least get a sense of the company's management.

If you're thinking about being the first franchisee, you need to weigh the potential risks against the potential rewards. Support services may be lacking, systems may still be evolving, and buying cooperatives to give you lower prices may not be available. In fact, almost everything the franchisor will know about franchise system operation and franchisee performance will come from working with you. Unless your franchisor has done its homework and is experienced, you're about to pay for the privilege of being a guinea pig.

But as the first franchisee, you may get your pick of location, negotiate a better franchise agreement, and obtain concessions that subsequent franchisees won't get.



TIP

You may want to consider a form of “prenuptial agreement.” Part of what you're expecting is that the franchisor will grow and you'll be part of a franchise system — with all the benefits. What happens if, a year from now, you're still alone? Or if in five years, just you and one other franchisee are in operation? Not all new franchise systems grow — in fact, based on our experience, many don't. Negotiate a walk-away clause that gives you the option to leave the system before your franchise term is finished if the franchisor can't grow the franchise system. Pick a number — a good one is the number that the franchise salesperson has been telling you the system will grow to during the next year or two. Have your franchise attorney discuss other options with you.

Being a franchisee of a new system is a tossup. You may be getting in on the ground floor of a great opportunity, or you may be joining the crew of the *Andrea Doria*. (Everybody uses the *Titanic* as a metaphor for disaster; we thought that, as franchise executives, we should be more innovative.)

- » Creating winning marketing plans
- » Exploring national and local advertising ideas
- » Knowing and serving your customers

Chapter **11**

Attracting and Keeping Customers

Optimism and luck are necessary ingredients for any business to succeed. And for every new business owner, remaining optimistic can be hard because every business has its ebbs and flows. But optimism can be a whole lot easier to sustain when there's a long queue of people wrapped around the block waiting patiently in line to buy your goods and services.

There is nothing as powerful to help you achieve this type of optimism than making certain that what you deliver to your customers is so compelling it will guarantee their return — again and again. Then you can sit back and watch how their posts on social media proclaim your greatness to everyone else. How well you consistently perform is the best way to obtain customers and expand your customer base. This chapter explores how to attract customers in the first place. It is up to you to give consumers a winning experience so they turn into real fans.

We begin with a few definitions. Many people use the words *marketing* and *advertising* interchangeably, but they mean different things. The savvy business owner knows the difference. *Marketing* is the big picture and involves every aspects of getting a product into the buyers' hands. If you pick up a basic marketing textbook, sooner or later you'll read about the four P's:

- » **Product:** Having the right products and the right quantity of products available to meet consumer demand

- » **Price:** Discount, competitive, or premium
- » **Promotion:** Getting your offer and message to consumers — advertising is part of what is in here
- » **Place:** Distribution and delivery to the customer

Advertising is an important piece of marketing. It is a paid communication that attempts to persuade, inform, or create an image in the mind of a consumer. Advertising is merely the messages you distribute to consumers through various media (social media, television, radio, newspaper, magazines, direct mail, Internet, and out of home).

Creating an Effective Marketing Plan

Unless they happen to stumble upon your location by chance, customers are not going to show up at your door unless they know you are there. If your business depends on customers coming to your door, having the right locations where they are going to see your brand on a regular and frequent basis may be the most important marketing investment you will ever make. You might expect that is the reason why the rent on the front pad of the shopping center is higher than the rent for the same space, 50 yards away, on the back of the center.

Here are two of the critical foundational elements of any marketing plan:

- » Sustainable and consistent great experiences by consumers . . .
- » Delivered in locations that are easily accessible and visible to them

There are a lot more. Marketing can be as simple — and as cost-free — as word of mouth. *Word of mouth* used to be your customers talking to their hairdressers, who tell their clients, who tell their friends, and so on. Now it is as simple as your customer posting about their great experience (or bad experience) on Yelp or Google or another rapid direct social-media site.

On the other end, marketing can be outrageous and costly. Parading an elephant draped with your company's banner through town may get you noticed, but to be successful, marketing has to be targeted to the right audience and must make sense for attracting new customers to your brand or reminding existing customers to continue coming to your brand.



REMEMBER

Marketing needs to be planned in a way that the audience will see it, and be cost-effective so you can sustain it.

Successful marketing campaigns are a unique blend of science and art. They present the right product to the right audience in the right manner at the right time. They require research, planning, and — with all the available platforms you have available to you — creativity to break through the clutter of messages your customers are confronted with each day.

Regardless of the methods you use — and you likely will have multiple methods for reaching your customers in your plan — *having* a plan is essential. Here are some ideas for developing an effective marketing plan:

- » **Do your homework.** Learn everything you can about your product, your concept, your customers, your marketplace, your pricing strategy and especially your competition. That is not enough, though. You also need to understand how your customers are using your products or services, why some are not doing so, and why they may be buying from your competitor and not you.
- » **Create incentives and a reason for customers to buy.** If your products and services are price sensitive, make certain that the deal you offer also emphasizes the features and benefits that your primary customers want the most. Price alone won't be sufficient to sustain your customer base. A strategy — even one based on a price that is too good to refuse — needs to reinforce to the customers selecting your products and services because of the benefits.
- » **Create your message.** Your message needs to speak directly to your targeted customers, clearly define who you are and what you're offering, and create a sense of excitement about shopping with you. If you are a franchisee and your franchisor is using an advertising or marketing agency, they will generally craft the message for you to use. Your goal will be to effectively communicate that message to your targeted customers.
- » **Make sure to properly deliver your message to your audience.** Messages may be delivered through traditional media, including TV, radio, print, out of home (billboards and so on), and direct mail, or through community involvement, sponsorships, and public relations activities. But more and more today, your message will be delivered through social media on Facebook and other platforms. Check with your franchisor on how you can use social media. Which method(s) you select depends on your concept, your offer, and your message — and remember, what works for one franchise may not work for another.
- » **Managing social media:** Subject to the standards, restrictions, and procedures required by the franchisor, what you post on social-media is within your control. What you may not have direct control over is what other people post to Yelp or other social-media sites. That doesn't mean you can't have some involvement when others post reviews or information about you. Check with

your franchisor on what its social-media response policy is and how and whether it wants you to independently respond to both positive and negative postings. Remember, just as the person making the review can have an impact on how people see your brand, how you respond will too.

- » **Keep your name in front of consumers.** Even though social media likely dominates how consumers learn about your brand and your performance, television is still a medium that has impact because it combines sight, sound, and motion with great entertainment value. As opposed to social media, where people may obtain an instant reaction, on average consumers need to see a TV commercial at least three or four times before they have any recollection of the message. Also today, because much of media content is viewed through methods that allow the viewer to by-pass commercials, the number of times a message is broadcast is no longer a guarantee that it is even being viewed by a large portion of your targeted consumer. Because of that and because of the variety of available programming and platforms, commercials must run many, many times before your targeted audience sees it even three times. Other media require even greater frequency, so using a combination of media to reach your target audience most cost-effectively is essential.
- » **Select media you can afford to use with the necessary frequency.** Cost is an essential element of your marketing plan. A print campaign that runs every week in a local paper or an organic or even a paid social-media posting may be more effective than a TV commercial that runs only a few times or late at night when your target audience is asleep. Avoid making the mistake of wanting to see your commercial on TV when the only person that may be watching it is you — and you knew the exact time it was to be broadcast.
- » **Talk only to people who can buy your product.** If your customers come from no more than five miles around your location, paying to advertise to a wider audience is a waste of valuable advertising dollars. Talking frequently to those who can benefit from your message is certainly much more effective than paying for wasted circulation.
- » **Pool your resources with other franchisees.** Collective investment savings are made possible because of the number of franchisees making or participating in the same offer. The same cost-saving impact affects your media costs. Spending your media dollars effectively should include combining your media efforts with other franchisees so you can afford a stronger advertising plan and even a local SEO strategy.

SEO is shorthand for *search engine optimization*. SEO strategy needs to focus on optimizing for search engines to ensure strong organic (not paid for) placement. Your messages need to contain the specific keywords people are using to search. This is a careful and deliberate approach that is best produced with specialized expertise in this area.

Many franchisors, through their franchisee advisory boards, work collaboratively to direct group media spends by franchisees and company-owned locations at the local level.

- » **Check out local media discounts.** Size is important, but as a local advertiser you may be eligible for local advertising rates unavailable to large, national advertisers. Ask before you agree to any media spend.
- » **Create cross-selling opportunities.** Aligning your business with a complementary business in your community can make sense. But before you start a cross-selling relationship with another local business, or establish a similar online relationship with another merchant using an electronic distribution platform, make absolutely certain that their business shares the same target audience with yours — and most importantly, that it shares the same business values with yours. You do not want your cross-selling efforts to backfire.
- » **Consider business-to-business partnerships.** Most retail- and/or consumer-based companies focus their marketing efforts on their core customers, which makes sense. The opportunity that many of these companies overlook is the formation of business-to-business partnerships that allow them ultimately to reach more of their core customers faster. For example, Budget Blinds formed strong relationships with real estate agents. The real estate agents act as an additional sales force to market the Budget Blinds brand through the distribution of gift certificates to their clientele. The cost to do this is merely the production of the actual gift certificates; the return on investment for this kind of deal compared to other forms of advertising can be tremendous!
- » **Monitor your results.** Do more of what works and change what isn't producing the results you want. Constantly measure your return on investment from your media spend. Track whether each flight of media investment results in an increase in sales. Also closely watch your customers' comments on Yelp, Google, and elsewhere about your business. Driving customers into your business by investing in marketing and then disappointing them with your product or service is not a workable strategy.
- » **Become a spokesperson to market your product or service.** Making a personal connection with customers strengthens the business. The more you become identified with your company in your local community, the better off you will be.

Brand marketing often boils down to dollars and cents. Franchisees of larger chains gain an edge because their collective marketing dollars can support national and regional campaigns. Smaller chains have to work harder because they lack the financial muscle. In either case, you, as a franchisee, have to do your part too.



TIP

It is estimated that 80 percent of the products people will need to buy in the future will be available from e-commerce companies like Amazon. If e-commerce is having an impact on your business, type “retail theater” into your favorite search engine, and you’ll see links that will help you understand how to use technology and what changes you should consider to effectively compete in an e-commerce world.

Evaluating National and Local Advertising Strategies

You didn’t join a franchise system to show off your marketing genius — that’s where your franchisor comes in. Part of every franchisor’s role is to help get the word out about your brand.

Franchisors often develop, depending on their size, local, regional and national marketing strategies and advertising campaigns. Some organize advertising cooperatives with franchisees in your area. Some may do no traditional marketing and instead focus most of their efforts on investing in social-media campaigns.

When it comes to local advertising that a franchisee may execute independently or in combination with other franchisees in their market, most franchisors offer marketing guidelines and suggestions and typically create the marketing and advertising materials for the system.

The franchise system ad campaign: Collective marketing dollars at work

Most franchisors today administer a system advertising or brand fund. In most franchise systems the *brand fund fee* is based on a percentage of location sales and can range from less than 1 percent to more than 10 percent. In some franchise systems, the brand fund fee can also be a flat dollar amount or based on the number of transactions conducted by the franchised business. There are even franchise systems that don’t charge a brand fund fee at all. The requirements and recommendations often depend on a chain’s size, maturity, and industry. You will also find brand funds where the system’s vendors and suppliers contribute to the funds through their supply arrangements with the franchisor.



REMEMBER

When considering any franchise, it's important to understand your marketing responsibilities. Be sure to discuss this with each franchisor you are considering and carefully review your responsibilities in the franchise agreement. Talk to the franchisees in the system about the franchisor's approach and probe with them the effectiveness of the brand's campaigns and whether the franchisor is efficient in spending the brand fund's dollars.

Not all brand funds operate the same way. Ideally, franchisees should have input, and most franchisors at some point set up marketing or advertising committees made up of franchisee and franchisor representatives similar to their franchisee advisory council. In other franchise systems, the franchisor makes all the decisions, and there are even a handful of brands where the fund is totally administered by the franchisees.

No one can guarantee the effectiveness of all marketing, but there should be safeguards in place to ensure that the brand fund is being used only for agreed-upon purposes. For example, if the fund's purpose is to market the brand, money for the fund should not be used to recruit franchisees — unless the franchise agreement specifically reserves the right to allocate funds for that purpose. The same goes for any other expenditure that's not related to the purpose of the fund.

Still, you can expect that there will be expenditures made from most brand funds that are not spent on advertising placement, including the costs associated with administering the fund, the franchisor's marketing personnel, the costs of maintaining the system's consumer website, SEO costs, fees paid to advertising agencies and public relations firms, and so on. The purposes of the brand fund will normally be set forth in your franchise agreement, so you should be able to easily see the ways and purposes for which funds can be allocated.



REMEMBER

Be aware of how much and what kinds of administrative and other expenses the franchisor is charging to the fund. Also, if the franchisor owns and operates company-owned locations, you want to understand whether those locations also contribute to the brand fund just as the franchisees do. You would hope so, but not all franchisors do.

As franchise systems evolve, the franchisor's policies in a host of areas, including marketing and advertising, will evolve and change. Franchise agreements frequently reserve the right to do things in the future that they are not ready to do today. This also applies to the brand fund.

Frequently when franchisors begin to franchise, they don't have a brand fund in place and don't intend to establish one for some time. But because they recognize that a brand fund can be an essential part of a mature franchise system, they reserve the right to establish a brand fund in the future. Some franchisors may impose a brand fee on the franchisees today but also reserve the right to impose a higher fee later on. The franchise agreement will provide you with information including the maximum brand fee a franchisor can impose and the conditions upon which the fund can be established or changed. In some cases, we recommend franchisors reserve the right to change or re-allocate the franchisees' fees and required marketing expenditures among the brand fund, local or regional cooperatives (discussed later in this chapter), and local advertising expenditures, without increasing the franchisee's total advertising spend. This gives franchisors the ability to shape their marketing and advertising programs as their marketing needs change.

From time to time franchisors may request that franchisees voluntarily boost their contributions to the brand fund. This may be necessitated by the demands of the market. In this case, the franchisor wants all franchisees to contribute at the higher fee being imposed on new franchisees. Although you likely have the right to just say no, you should listen and evaluate the franchisor's arguments for increasing the fee. In other cases, franchise agreements may permit the franchisor to increase the franchisee's contribution to the brand fund upon the positive vote of a majority of existing franchisees.

Local marketing options

Local marketing is your opportunity to attract customers to your business location. In most franchise systems, franchisors require or recommend a level of local advertising expenditure. If it is required, the franchisor may specify a percentage of sales or it might establish a fixed amount you are required to spend. Although the franchisor is specifying an amount, it is a minimum amount and may not be all of the advertising that your business requires.

The reason the franchisor won't determine your total advertising requirement is because markets and locations differ. If you are the first location in a market and the brand is new to consumers, you likely will need to spend more than franchisees in markets where the brand is well known and the franchise system has established critical mass.

In some systems you will be introduced to the concept of an advertising or marketing cooperative. When a cooperative is established, you will likely be required to contribute a portion of your local advertising expenditure or a percentage of your brand fund contribution to the local cooperative. In some systems the franchise agreement may even require you to contribute an additional percentage of

sales to the cooperative. When a cooperative is established, you will be pooling your local advertising dollars with other franchisees in your market or region so that collectively you can afford bigger media buys on radio, TV, out of home, print, direct mail, and so on. The cooperative may be set up as a legal entity or as a loose affiliation of franchisees, normally governed by bylaws prepared by the franchisor. Sometimes a local advertising cooperative may even have a local advertising agency, selected by the cooperative members.

Cooperatives are also a great tool used by franchise systems to ensure that you and other franchisees who share a market have a consistent advertising message to consumers. Imagine if there are 15 franchisees in your city, each advertising a different offer in a different manner, as opposed to advertising that sends the same message. Which approach does more to promote the brand? Cooperatives are also a useful tool in keeping your local web pages consistent across the market and an effective way for a group of franchisees to manage their social-media messages, digital marketing and consumer comments.



REMEMBER

Most franchisors will have a library of marketing materials that you can use or customize for your business. You may also elect to produce some of your own local marketing materials — but you likely will require some form of approval from the franchisor before you use any of it. Check with your franchisor about its approval procedures.

Before you do your own thing, understand the importance of complying with your franchisor's approval procedures:

- » Do your materials maintain the franchisor's brand identity?
- » Are you confusing customers by sending a message that is different from the national campaign?
- » Does your campaign actively sell your product or service?
- » Can you afford to create new materials instead of using those provided by your franchisor?
- » If you are using any form of direct electronic marketing, like emails, are you meeting the legal requirements for those methods? Violations can be very expensive.



WARNING

Make sure that the local marketing materials you want to create are worth the cost, because every dollar you spend on creating new marketing materials is one less dollar you will have to use on marketing your business. Also, before you spend any money creating your own website for your location — before you set up your own SEO campaign, before you sign an agreement for pay-per-click marketing campaigns with Google or another search engine — be aware that you likely don't

have the right to do any of that on your own and most assuredly not without your franchisor's permission. While radio, TV, newspapers, flyers, and so forth can be local, the Internet is not. Your franchise agreement likely does not give you the right to register any URL as a franchisee, and electronic media comes with serious legal obligations you need to fulfill.



TIP

Carefully investigate and assess your franchisor's marketing resources and support — it may have just what you need and are required to use and save you a lot of money, time, and grief.

Local promotional activities can be a powerful way for you to be seen as part of your businesses community. You've already told your customers that although the name on the store may be the name of a chain, the business they're shopping in is locally owned and operated by you. You did that with the sign on your wall, on your business cards, and on your invoices.

Even if your staff wears a uniform with your franchisor's name on it, they know you are a local businessperson because it's your name on their check, it was your name on their job applications, only you determine how much they make, and you determine the HR rules for them to get raises and to maintain their jobs.

Still, even though you've told customers and staff that you are locally owned and operated, you are still operating under the franchisor's brand and your local promotions need to be compatible with your brand's policy and image.

Not every possible promotion is right for every brand. Say you're a cookie store and you sell your cookies to moms and their children. Another potential customer might be someone shopping at a nearby medical marijuana store. Likely you would gain a slew of new customers by handing out flyers at the local medical marijuana store. But is a medical marijuana store really a place you or your franchisor wants to see the system's brand linked to? Promotions not only need to say the right words, they also have to be targeted to the right audience. Consider doing the following:

- » **Sponsor a Little League team.** Provide the kids with T-shirts with your name. (Your parents probably still have your Little League shirt!)
- » **Reward students.** Hand out discount coupons or announce in social media frequented by students the availability of free products. Or develop award certificates for children who excel in school.
- » **Use email marketing.** Email marketing can be powerful, but the use of email is more challenging today than in years past because of regulations meant to protect consumers from spam. Make certain your franchisor authorizes you



TIP

to use email marketing. Even if it does, make certain you don't violate anti-spamming laws.

The CAN-SPAM Act covers all commercial messages, including any electronic messages containing commercial advertising or promotions. Information on the CAN-SPAM Act and its requirements can be found on the Federal Trade Commission's website (www.ftc.gov/tips-advice/business-center/guidance/can-spam-act-compliance-guide-business). Be aware of state and local laws as well.

» **Participate in charity promotions.** As a franchisee, you will find that participating in a community event or charity work will also promote your franchise. It builds goodwill and it can build sales. Many franchisors encourage franchisees to support charitable causes that are most appropriate for their local communities and that are in alignment with the brand. See whether your parent company offers guidelines on charitable promotions. It is good form to steer clear of controversial or political issues that could polarize a segment of your customer base.



REMEMBER

Check with your franchisor as to whether costs of your promotional activities are credited to your local marketing expenditure requirements. This is probably the case, but it is better to know for sure. And be sure to let your staff know about all your promotions and marketing efforts. Consumers easily become frustrated when they visit your business looking for that great offer only to find out no one working there is aware of it.

Any marketing, advertising or promotional materials that involve the franchised business and that include the franchisor's trademark must almost always be submitted to the franchisor for approval in accordance with the franchisor's approval procedures.

Franchisors take local advertising seriously. Ask your franchisor for guidance on appropriate media and talk to other franchisees about what has worked and has not worked for them. Most likely, you will have to document advertising expenditures. Your operating manual should specify what counts — and what doesn't — toward authorized expenditures.



TIP

Your field consultant and your franchisor's marketing department may be able to help you evaluate the effectiveness of any promotions or campaigns. Just understand that you don't want to wait until the end of any promotion to find out that it's a dud. If it's broke, fix it as you go. A minor adjustment to your offer or message could save the day.

Most franchisors prepare advertising materials for use by franchisees, and frequently make that material available on the franchisor's intranet site. Some

intranet systems used by franchisors today allow you to customize advertising material for your location or they present the material in modular format, permitting you to tailor your exact offer while maintaining the overall look associated with the brand. Usually, the layout will include space for your name, address, telephone number, and hours of operation. Your local newspaper or direct-mail house can handle the production for you.

Broadcast advertising is similar. Your franchisor will provide you electronically its radio spot or television commercial with time allotted for your local identification. Your local TV or radio station can take it from there.

Ready to get started? First make certain your business is ready for the flood of customers you hope will come. Remember that although getting customers is important, retaining your customers is essential to you and for every other franchisee in the system.



WARNING

Before you start any marketing campaign make sure your business is ready for prime time. If you don't run your business right, telling people who and where you are won't help you. Disappointing your customers means that ultimately you won't have any. Your business must deliver products and services based on the quality standards of the franchise system and give the customer what the franchisor's advertising campaign has promised.

All Hail Customer Service

Your customers are coming to your business because of the products and services they expect to get under your franchisor's brand. It is the franchisor's brand under which you operate — the brand is on your signs at your location and it's on the side of your trucks. Your job is to represent the brand and, as an independent business owner, do so in a way that makes your location a place where customers know they will get the franchise system's products and services just the way they expect.

First on your agenda is knowing who your customers are.

Knowing your customers

Knowing who your customers are is essential if you want to deliver great customer service. Having an understanding of your consumers' wants, needs, buying habits, age, gender, lifestyle, pocketbook, and time schedule will give you the clues you need to serve them better.

No doubt, getting this type of basic information sounds difficult, but it's not. Much of the information you will need will come from other franchisees in the system and from the franchisor. But supplementing this information with specific information about your market is important.

Customers should be storming your business because you, your franchisor, and all of the other franchisees in your area and throughout the system have done a great marketing job — at least that's the plan. Your job is to gain additional insight into your local consumers and share that information with your franchisor and fellow franchisees. Because you're going to have a personal relationship with your customers and are going to understand at a basic level how and why they buy with you, sharing that information is an important contribution you can make to your franchise system.

Your franchisor and other franchisees will help you do this without your having to knock on every door in town. We have moved into an integrated tech economy and culture. Point-of-service (POS) software used by many franchisors enables the capture of information about consumers' profiles, buying habits, attention to advertising activities, price and discount sensitivity, their reaction to new products, how they prefer to receive products and services, their use of affinity programs, and on and on. Some larger systems, like hotels, have private-label credit cards and frequent-buyer cards to track purchasing trends.

Be observant and train your staff to be observant. As a locally owned business, paying attention to your customers will help you anticipate their changing desires. In an economy where more and more consumer purchases are being made online, having information on why customers choose to purchase from your brick-and-mortar location and what you and your staff do to close the sale — rather than take their business to an e-merchant — is important. Although the integration of technology has been effective, when leveraged with the competitive advantage of the human, person-to-person sales process, your business can really excel and your franchise system's ability to compete is enhanced.

Providing your customers true value each and every time they shop at your location involves more than mere competitive pricing. Achieving total quality with a keen eye on how you operate your business to meet the franchisor's brand standards and the needs and wants of consumers is critical.



REMEMBER

Even in the best franchise systems, with every franchisee having the same tools for success, franchisees will still fail. The difference between success and failure when that occurs is most often the differences between how one franchisee and another use the same tools to operate better. It's really simple: If you give your customers the best service and the best product, in the way they want each delivered, they will be back.

Showing honesty and integrity

Honesty and integrity are two of the traits you wanted in a franchisor when you made your investment decision. Customers are looking for the same traits in you. If you don't demonstrate honesty and integrity, without any doubt other businesses will quickly scoop up your customers.

It's hard to build a great reputation with consumers — it takes time and it often costs money to do so. And it can be gone in an instant. You are a step ahead of the game if your brand already has that reputation and you are counting on the entire system, including the other franchisees, to maintain that consumer perception.

Customers expect to receive the product or service your franchise is known for consistently. They expect with certainty that how the brand is portrayed to them in advertising will be what they will receive. Your job is to give that to them every time so that not only your own business succeeds but also the reputation of the entire brand doesn't get tarnished.

Franchisors must respond to consumer buying patterns. Care must be exercised in what and how new products and services are added — and old ones retired. It may be an old example, but it still resonates today: Sears quickly entered its long slide into obscurity because it confused consumers after launching its “softer side of Sears” marketing thrust. Sears misjudged the difficulties of going from a brand known primarily for appliances, tools, and home goods to a new brand position offering socks and cocktail dresses. Sears confused both old and new customers, and even when it tried to return to its base, found it had lost its brand equity.

Evolution and change in every brand is essential, but if your franchisor is constantly changing the operations and focus of your business, consider whether undue stress is being imposed on your operations and, more importantly, confusing customers. Consumers need to understand at a visceral level what your brand means, what your brand delivers to them, and what as a system it stands for.



REMEMBER

It's important to work with your franchisor to help the system evolve, but it is also important that you provide your feedback when changes taking place are not achieving those goals. If your franchisor has a franchisee advisory council or a franchisee association, working on these issues through those organizations can be effective.

Before launching new products and services and before they retire others, smart franchisors conduct research and testing to ensure that these changes are what customers want. Participating in these tests when you are asked to do so and working to provide the franchisor with the information it needs are positive contributions to the franchise system and you should look for opportunities to do so.

Every customer has a good memory. Customers remember the promises and perception of what every ad said about your brand — and they also remember when it is not delivered. Today, even before they leave your store, and from their tablet or their phone, customers will tell their neighbors and the world about what they like, and more often, what they do not.



WARNING

When you don't meet each customer's expectations, you not only will say goodbye to them as returning buyers but likely have also lost others they have influenced in person or online.

So when the brand makes a promise — even if you disagree with it — you most certainly need to live up to it. Customers will more frequently post online and tell their friends about a bad experience because they expect a good one.



TIP

Take the additional steps needed to maximize each individual customer's satisfaction and you will reap a positive domino effect. Customer satisfaction is the best marketing you can have and it is the best tool to ensure that customers will visit again and more importantly tell others to visit you too.

Making sure customer experiences are positive (and fixing ones that aren't)

You will face all kinds of customers at your business. Sometime customers will be using your location simply to experience and try out your merchandise, fully intending to go home and buy it online because they think online purchasing is more convenient or lower priced. How you show that customer why your buying experience cannot be matched online will allow you to compete in a tech-driven retail economy.



REMEMBER

You need to be on your toes at all times and maximize each touch you have with your customers. Bad things *will* happen, and how you positively and quickly respond to them and your customers will significantly impact your customer's views, potentially changing a negative experience into a positive one. If you don't approach customer service in this manner, expect your franchisor to take some action to protect the brand.

When mistakes happen, look inward first. Strip apart your operations and see what improvements and changes are needed. Go back to the basics of what is in your franchise operations manual and training material, because they often will remind you of what you should have been doing to avoid your particular problem. Don't be bashful about admitting your problems and seek help as early as possible from your franchisor's support team and other franchisees. If the problem you discover is within your staff, consider retraining your employees or replacing them.

Bottom line, in responding to customer problems:

- » Respond quickly.
- » Listen to what your customer has to say — without interruption.
- » Apologize and then apologize again for any errors.
- » Be polite and make eye contact.
- » Put yourself in your customer's shoes — think about how you would want the problem resolved.
- » Promise your customer a correction — free product or services, discounts on future sales, shifting employees, extra attention, and so on.
- » Prove yourself the next time.
- » Make certain that whatever occurred doesn't happen again.

Be aware that very few customers verbalize their complaints to employees or management, especially if money is not involved. More often, you find out about poor customer service when it kicks you in the stomach and you read about it on Yelp even before the customer reaches their car in your parking lot.

There are many ways to understand whether your customers are happy, and the best way is to do so personally is with your eyes and ears. Listening to and watching customers and employees is important. Staying on the floor and observing your business at all hours is more important than sitting in your office in back of the store doing paperwork. You can get your administrative and other duties done at more appropriate times.

Here are some other ideas:

- » Read your mail, email, Yelp and other social-media sources and don't discount, dismiss, or rationalize the ones you don't like.
- » Solicit input from customers, vendors, and your staff.
- » Talk to your customers directly. Don't just stop by the table and ask them how things are going. Introduce yourself, be a positive part of their experience, and hopefully they will share with you a small problem before it becomes a bigger one.
- » Use the sophisticated tools you may already have at your franchise, such as your POS system that captures sales and customer information. These tools can help you schedule your staffing better to meet customer requirements on a moment-by-moment basis.

- » Go the extra mile and hire a local research company to gather quantifiable research on your business's consumer performance. If you want to hire outside experts, talk to your fellow franchisees about combining forces and splitting the cost.

Looking beyond your cash register

Every part of your business makes an impression on the customer. No question, the end product or end service offered by your business and the franchise system is why customers come in the door to begin with. But customers also notice how well you run your business. Things like maintenance, employee appearance, and friendliness do matter. For all shoppers, especially parents with small children, not having a clean and well-stocked restroom might lose them as customers — because they may have made their shopping decision precisely because you have a reputation for the cleanest restroom in town. Paying attention to detail is a big part of customer service. It's also an important part of retaining your staff and enabling them to give great customer service. Nobody likes to work in a dirty environment.

Your job at the local level is the same as your franchisor's at the system level: setting, enforcing, and achieving tough standards — because if you don't, your customers will.

As you look at your business, consider the following:

- » Do you have enough staff or the right experience mix on duty at all times?
- » Are your employees friendly, helpful, and well trained?
- » Are problems resolved quickly?
- » Is service prompt, dependable, and consistent?
- » Is the location clean, welcoming, and in good condition?
- » Can your customers see your quality as they drive by? What does the outside of your store say to your customers?
- » Do customers or employees have concerns about security or safety?
- » Is equipment updated?
- » Are products in stock?
- » Are you offering all the products the customer expects from your brand?

- » Are you meeting the needs of the physically challenged customer?
- » Are you available to answer questions or resolve your customers' problems if needed?

A perfect business is never going to be possible, but reaching for it consistently is. It takes time, teamwork and frequently, an additional investment on your part. The most important part of striving for the perfect business comes from you and your staff and how you have dedicated your business to meeting brand standards and customer expectations.

4 Expanding or Cashing Out

IN THIS PART . . .

Grow your business with multi-unit franchising.

Know when and how to close up shop and put the business up for sale — or pass it along to a chosen successor.

IN THIS CHAPTER

- » Buying more than one franchise: pros and cons
- » Complying with your franchise agreement
- » Evaluating personal and financial resources
- » Exploring purchasing options

Chapter **12**

Acquiring Other Franchises

Many franchisees open one unit and then later on, maybe, add additional franchises. Typically, they obtain franchises for each additional unit separately, one at a time and simply sign a new franchise agreement.

Other franchisees make the decision to obtain development rights giving them the right to open multiple units in single or diverse markets over an agreed period of time. Still others seek to become master franchisees with the right to essentially stand in the “shoes” of the franchisor by recruiting their own subfranchisees who operate franchised units under the franchisor’s brand.

This chapter addresses the key issues you should consider when obtaining additional franchises and how to assess the advantages and disadvantages of being a multi-unit operator.

Assessing the Advantages and Disadvantages of Multi-Unit Operation

You are a successful franchisee. Your business is doing well, it is showing great promise, your relationship with your franchisor is outstanding, and you are having no problems servicing your debt or in meeting your payroll. The question you are now asking yourself is: Is it time to expand?

It might be, but first ask yourself the big questions: Will my success continue, and should I expand the number of units I'm operating to take advantage of my success? The answer is: It depends. The reality is that acquiring more units can have advantages and disadvantages. This section is devoted to discussing them.

The advantages

Intuitively, you know that the more businesses you own, the more potential you have to get more customers, increase sales, and make more money. As a multi-unit franchisee, you may have the opportunity to build equity in your business faster than you could as a single-unit operator. Because of your increased sales volume, you possibly can negotiate better prices on supplies and maybe even get a better deal with landlords or even your franchisor. Being a larger franchisee may also yield benefits in your ability to obtain more favorable financing.

Marketing your new chain is going to be simpler because with more than one location, you might be able to afford to run radio and television spots that would be financially difficult for you to justify or afford if you only had one location. Even the cost of obtaining customers goes down because as a regional player your costs begin to fall into a lower range on a per-unit and per-customer basis.

Think of the benefits to your employees who now can see career opportunities in your growing organization. You may qualify for lower rates on health-insurance plans and might be able to construct better benefit packages to attract and maintain your management and staff. You may also be able to offer candidates choices on where to work closer to where they live.

The benefits continue — a single manager could take on responsibility for multiple locations, and you can float employees between units as demand dictates. If the new manager at your pizza franchise makes a mistake with the cheese order and runs out of cheese on the very day that the town's soccer teams are having pizza parties to mark the end of a brutal season, she can rush over to another one of your units to replenish the supply — and satisfy lots of little customers (who will grow into big customers someday).



TIP

You may also be able to set up a warehouse or a *commissary* (a central location where you can prepare some products for all the units) and ship products to all your units in a prepared or semi-prepared fashion. This approach is acceptable in some franchise systems and restricted in others, so be sure to check with your franchisor. Participation in a buying group or purchasing cooperative with other franchisees can also facilitate similar cost savings. See Chapter 8 for more.

Consider pricing too. Although franchisors can establish retail pricing, in most franchise systems they generally allow franchisees to set the prices they charge to their customers. But with multiple franchisees in a market, as a practical matter prices for products and services may be inconsistent from one franchisee to another as there can be important legal restrictions that prevent franchisees from agreeing together on the pricing for the products and services they sell. When you own all the units in a geographic area, that won't be a problem for you or the franchisor.

As a multi-unit operator, your influence with the franchisor and with other franchisees expands as does your ability to manage your costs. Franchisors tend to listen to the people with the loudest voices, and those are the franchisees with the greatest economic power. That's just human nature.

The disadvantages

With more units you're going to have more at risk than smaller franchisees in your market, and the performance of those franchisees will affect your performance. Don't forget that consumers view you all as part of a chain and even though you have a sign that says "LOCALLY OWNED AND OPERATED," the lack of performance by one franchisee impacts all the franchisees.



TIP

Make sure you stay informed on how your neighboring franchisees are doing. If necessary, consult with them on improving your market's performance.

To be an effective multi-unit operator, you'll need a great internal organization. You will need staff, systems, and the financial capabilities necessary to succeed. Having a plan is essential because it will allow you to grow at a pace you can support. Without a plan, and without your leadership and management skills, operating successfully can create some serious problems for you as you expand.

Planning is critical, and you might even think of bringing in other businesspeople as joint venture partners and advisors. This approach may make your piece of the financial pie smaller, but a smaller share of a bigger pie is much better than 100 percent of a sliver.

"The critical areas of focus in becoming a multi-unit franchisee are capital and management," says David Barr, founder of PMTP Restaurants and second vice chair

of the International Franchise Association. “Specifically, in many systems, being a multi-unit franchisee that achieves economies of scale requires managing at least \$6 million of revenue from all units. This scale then allows the hiring of additional multi-unit management, other than just the franchisee. Thus, it is important that franchisees take an inventory of their available capital as well as their management in order to assess if they are ready to add units and achieve scale. Many franchisees provide the analogy that when managing one or two units, they are playing man-to-man defense. However, when managing multiple units, they must play zone defense, and one person cannot play zone defense. Be sure to have your capital and management plans in place as you begin the multi-unit journey.”



WARNING

Don't think that you won't have to play an active and engaged role in managing your business or that you can take liberties with the franchise system requirements. Doing so can have serious consequences on your business and your relationship with your franchisor and the other franchisees in your market. Take your time and realistically proceed with caution.

Checking Your Franchise Agreement: Can You Buy Another Franchise?

Review your franchise agreement. There are franchisors that will allow you to grow but will never, ever offer multi-unit development rights to any franchisee. They want you to grow one unit at a time to ensure that each of your locations is operating up to brand standards before you have the right to open more. Others will offer you a development agreement and give you the right up front to open and operate multiple locations.

Many franchisors may include *cross-defaults* in their franchise agreements. If you operate any unit in a way that allows the franchisor to terminate one franchise, it may also have the right to terminate all your franchises. Some franchisors have a set waiting period before you can open another unit or obtain development rights in another territory. (Population or geographic area typically defines territories.) These franchisors may want to make sure that you can operate your first business fully in compliance with system standards, and do so profitably, before they will consider letting you invest in additional units in other markets.



REMEMBER

Understand your franchisor's multi-unit investment opportunities. If the franchisor offers development opportunities, you will generally see a form of agreement addressing those development opportunities in the FDD. If not, check with your franchisor to understand its policy. Make sure you know about any fees you will need to pay for additional development rights. Some franchisors charge lower up front fees for franchisees who are willing to commit to opening multiple

locations, and some will even charge a lower continuing royalty. You may receive a different level of support and need to incur additional obligations.

Reviewing Your Resources

Having one unit is far different from having 10 or 20. It's like having another child — the entire dynamic of your family structure changes. You need to deal with issues on a whole different scale, including hiring staff, training, purchasing products, and marketing. You may know the old adage: *Small children, small problems; big children, big problems.*

We strongly recommend that you develop a strategic and tactical business plan for your expansion before you decide to seek multiple franchises. Your plan doesn't have to be as grandiose as a Fortune 500 company. Before you think you can do without a plan, consider first that your banker or other investors *will* want to see one before they lend you the money you will need.

Be honest: Are you really ready?

Take another look in the mirror. Successfully shifting from a single-unit operator to a multi-unit operator can depend on personality and personal issues. Before jumping into the pool, make sure you're ready to swim:

- » **Are you a team leader or a team player?** The more units you operate, the more staff you will need, including some managerial employees. Be sure you can handle leading and coaching a bigger team to success. Decide whether you're able to give up some decision-making authority to employees whom you have hired and trained, and whom you trust.
- » **Are you an operator or a manager?** Saying you want 50 units is easy; understanding what it takes to open and manage that many units is another thing. Single-unit franchisees worry about opening the business in the morning, taking care of the events of the day, and closing at night. As a single-unit franchisee, you may be used to greeting your customers, training your employees, and taking care of many of the hands-on tasks yourself. Become a multi-unit developer, and you must become a leader and manager. You will have to build and rely upon a well-trained support organization to greet those customers every day.
- » **Can you delegate responsibility?** No question, letting go of day-to-day control of your first unit will be tough, but you can't be in two places at once. You will need to develop a qualified staff and begin to delegate responsibilities and decision-making responsibilities comfortably. You will likely spend a lot of

your time developing new locations and then nurturing the development and operation of each new unit. You won't have the time to focus your attention on your other units, and unless you're comfortable with delegating responsibilities, your small chain of operations may become riskier.

- » **Are you organized?** Discipline and organization are key. So is managing priorities and time. You may be at a construction site for your new unit on Tuesday morning and a staff meeting at an existing unit in the afternoon. Assuming responsibility over multiple units, with different problems and somewhat differing obligations, may make you feel like a juggler sometimes, and you will need to set up internal support systems, such as hiring a general manager, a bookkeeper, and an administrative support staff to free up your time. You most likely will need an office where you and your staff can manage your growing chain.
- » **Is the timing right?** If you do this will you be able to maintain your desired lifestyle? Remember that for a while, personal time is not going to be something you'll have in abundance.
- » **Do any family members want to get involved?** Perhaps your spouse and children want to become involved. Ask your franchisor if it has a "next-gen" program and discuss with your franchisor what you need to do to ensure that your family members meet your franchisor's requirement as operators. (In Chapter 13, we discuss leaving your franchise to your children.)
- » **Is one brand not enough?** Sometimes expansion comes under a different brand with a different franchisor — or even with a non-franchised business. Make certain you understand whether your franchise agreement will allow you to invest in other franchised or nonfranchised opportunities, because in some situations you may not be able to do so.

Look at your business and finances

If you already operate one unit, we hope you conducted some research before you made that purchase. Before you make the leap to multi-unit operations, closely examine your existing business, your finances, and yourself. Ask the right questions before you move forward:

- » **Do you have the money?** Your existing unit should be profitable. Many franchisees dip into cash flow from one franchise to fund all or part of their next unit, and then finance the rest as needed. No matter how many units you operate, you can't make money if the units you're operating are losing money. What are the costs involved in developing new locations? How much of your existing business will you be able to leverage into your expanded operations?
- » **Are your employees ready?** Have you been grooming your employees for promotion and added responsibilities? As a single-unit operator you probably

have an office or store manager, but with multiple locations you're going to need more managers and maybe even a district or general manager. You'll also need someone to train your employees.

- » **Do you have your operations perfectly down pat?** Is your existing unit operating in accordance with the franchisor's standards? Although you probably won't be an absentee owner — something we strongly discourage — you can't possibly be as hands-on as you are with your existing single unit once you add new locations to your business. Sit down with your franchisor's field consultant for an in-depth evaluation of you and your operations — and to make certain that any bad habits you may have picked up are not transferred to your new locations.

The amount of your initial franchise fee for your additional locations may be different than what you paid for your first. Some franchisors charge the same franchise fee for a second unit, and some reduce or even slash it for subsequent ones. Depending on the number of locations you plan on adding, you might even find that the royalty you pay — even on your existing location — will go down. It's not standard, but it does happen.

Be sure you understand your financial condition and how well you're actually performing. There are a few basic things you need to preliminarily focus on:

- » **The balance sheet:** Your balance sheet breaks down your *assets* (cash, real estate, inventory, depreciated equipment, and accounts receivable) and *liabilities* (outstanding bills, including tax obligations and loans). How financially secure is your existing business, and how will your balance sheet look to your bank or outside investors?
- » **Return on investment (ROI):** Are the financial results you're achieving from your existing business operations outperforming other investment opportunities that may be available to you? You need to calculate whether the return you expect to receive from adding new locations is better than you could get from investing in something else — including another brand. For example, if you're earning 3 percent on your investment in your business, and another opportunity is paying 6 percent — even if it's a passive investment — you need to decide whether investing in more franchises is a smart decision.
- » **Exit value:** What is the *exit value* of your current business? Do you know how much your business is worth if you sell it now? Can you get a better return on your investment in your current business by selling it and investing elsewhere? Will having more locations in a particular market be a good investment for you in the long term?
- » **Budget:** Do you have an operating budget for your existing business? How well has your existing business been performing against this projection? An *operating budget* helps you project income and expenses for the coming year,

which you can then compare to actual income and expenses. Don't forget to budget for offices and administrative and other staff to support your new and growing chain of units.

- » **Profit and loss statement (P&L):** Your P&L documents how well you're doing financially and tells you whether you're profitable or unprofitable. Is your existing business able to service your debt and provide you with the income you require to meet your definition of success? Are there areas in your current operation you can leverage across all of your locations? Are you including in your P&L costs that really have no relationship to your business (your car, children's nanny, vacation)? What does your business really look like when you strip it down to only those items necessary for you to run that location?
- » **Cash flow:** Your P&L is only part of the story. In business, cash is king. Know how much cash you're generating from your existing business before investing in additional locations. Do you expect the cash flow to be the same in the new locations? Are the locations going to require you to adjust your expectations of cash flow?

These tools can help you identify whether you can afford to expand — using your current cash flow or by seeking financing. There are other things to consider as well. Will your bank support your growth and what are the current interest rate and payment terms available to you? Interest rates have been very low for a long time, but higher rates could dramatically alter your investment decision. Also, the escalating costs of real estate and construction may require you to borrow more money than you did on your first locations. How willing is your bank to work with you to come up with a long-term financing plan to support your projected development?

It's likely been a few years since you developed your current unit. What your franchisor is now including in the cost of development may have changed. Don't assume that you'll pay exactly what you paid the last time you invested in a franchise. Some costs may be lower — such as a reduced franchise fee — but may be higher because of a new design or décor and equipment package. Consider all your initial costs.

When planning, and if you're investing in development rights, remember that you typically will pay a portion of the initial franchise fee up front for your unopened units as a development fee. This outflow of cash will come way before your units open and you begin to generate any revenue. This prepayment will have a profound impact on your cash flow.



REMEMBER

Even if you're operating a single unit successfully, making the change to multi-unit ownership will change your business equation significantly. Don't forget to review your financial state of affairs with your franchisor's development staff, your lender, your lawyer, and your accountant before making any final decisions.

Understanding Your Purchase Options

You have to decide *how* you want to expand. This will also depend on how your franchisor will let you grow. You may be allowed to open multiple units, acquire an entire territory, or convert an existing operation, but regardless, you'll need to deal with *where* to establish your next location.

Unlike when you chose your first location, you now have some practical experience in what works and what doesn't. Go back to the drawing board and diligently pursue site selection with the same gusto you had the first time around. You may think you know your market inside and out, but you need to be aware of other considerations. For example, a unit in a different neighborhood or even on a different avenue in the same neighborhood may have totally different dynamics than your current business.

Traffic patterns will likely differ, your customer base could change, your competition will be different, and you will even have to consider which side of the street a potential location is on. Your franchisor should help you with site-selection guidelines.

Starting from scratch

You always have the option of simply going through the same process you did when you opened up your first franchise: Purchase a franchise from the franchisor, locate a new site, and develop it fresh from the ground up. That's how most franchisees go from being single-unit operators to multi-unit operators — by building one unit at a time.

Depending on how long ago you selected your last site, your franchisor may have new site-selection tools available to you. There are territory-mapping solutions that are frequently used in franchising. Although most will have the same core functionality, each will have its own unique set of features as well as differences in navigation. Before selecting any mapping software, you should do a demo with several options to find the one that will work best for your needs. Here are four, commonly used in franchising, to get you started:

- » Maptitude, by Caliper (www.caliper.com/maptovu.htm)
- » Esri (www.esri.com)
- » eSpatial (www.espatial.com)
- » GbBIS (www.gbbis.com)

Investing in multiple units

Although franchisees often grow their chains one at a time, many franchisees choose right from the start to become multi-unit operators. Although most franchisees are individuals, some multi-unit operators may also be investor groups, and some may even be public companies that are larger in size than the franchisor. It's also becoming common for franchisees to invest in franchises with multiple brands. Those “strategic” franchisees look to use their existing back-of-house support team to expand into new opportunities.

Be prepared to sign additional documents when you choose to start out as a multi-unit franchisee. The franchisor will present you with what is called a *development agreement*. The development agreement will detail your obligations for opening up your units and typically will define three things:

- » The number of locations you are agreeing to open
- » The time period in which you must have the units up and running (typically detailing a date certain for each location)
- » The area where you and the franchisor agree you will open your units



WARNING

Although the development agreement will look fairly straightforward, as with all legal agreements you need to understand what you're signing. In addition to paying a development fee, you need to know whether and how that fee will be applied to your individual franchise fees. You must understand what happens to your fee and to your agreement if you don't meet your development obligations and you should also understand whether the development agreement includes any cross-defaults. A cross-default may link all your franchises together — a default or termination in one means a default and termination of all.

Finally, for each franchise you open, you will be signing a new single-unit franchise agreement. In most franchise systems, the agreement you sign will be the agreement the franchisor is then offering to other franchisees — with some modification to the terms as contained in your development agreement. You generally will be obligated to sign an agreement even before that agreement was even written by the franchisor. How is that possible? Each year the franchisor may change its franchise agreement. The agreement you sign in year two, three, and four may not be the same you signed in year one.



TIP

An experienced franchise lawyer can help you understand the agreement and possibly negotiate for you a different deal.

Buying a franchise from another franchisee in the system

Sometimes you want what you can't have, like your fellow franchisee's location. On the other hand, maybe you can.

Existing franchisees from time to time want to sell, and often the franchisor will facilitate sales by establishing resale, finder, or referral programs for existing franchisees. Those programs alert the system that an existing franchise is for sale and can result in a quicker sale to existing franchisees because the franchisor doesn't have to do as much investigating on an existing operator. These programs are also used by franchisors to help franchisees sell their businesses to new franchisees not yet in the system.



TIP

You don't have to wait. Stay in touch with other franchisees in your system, especially the ones in your market area. You will likely learn about franchises available to purchase even before the franchisor finds out about it.

But don't rush headlong into the deal. Find out first why the other franchisee is selling their business. You also need to understand what the franchise agreement says — yours and theirs. Usually, the franchisor will reserve the right to approve or disapprove a proposed transfer to an existing franchisee based on specific conditions. Generally, these include whether the existing franchisee has been in compliance with the franchisor's standards, and likely include the operational and financial performance of the franchisee's units.

You may have a requirement to bring the location being transferred up to current standards — meaning you may be required to invest in updating the décor and the equipment. Also, most franchisors retain a *right of first refusal*. This means that your franchisor can match any bona fide offer and purchase the selling franchisee's business at the same price you're offering. Most good franchisors will also evaluate the deal even if they don't want to purchase the business themselves. If the purchase price, in the franchisor's opinion, is too high, and how you plan to finance your purchase leaves you with more debt than the business can support, the franchisor may turn down the transfer until the economics of the deal doesn't put the business in jeopardy.

Read the fine print in the franchise agreement regarding transfer conditions and discuss the expansion criteria set by your franchise system. If you've not been playing by the rules in your existing franchise — maybe the franchisor has in the past sent you a default notice — the franchisor is unlikely to let you purchase the new location. Why would it want an operator who isn't running their existing units well to expand further in the system?



WARNING

Becoming a franchisee is complicated enough and requires you to have a lawyer working with you, but purchasing an existing business adds additional complications. Be prepared to work with your lawyer, your accountant, and maybe even a business appraiser in completing this type of transaction.

Measuring proximity to yours

In considering buying an additional franchise, you need to evaluate the selling franchisee's proximity to your current site. Is the site so close to your existing store that you won't get any true benefit — or is it too far away for you to properly manage? Maybe the area the site is in has changed since it was opened, and the change is having a negative effect on the operation.



REMEMBER

You don't want to invest a great deal of money only to find that you're splitting, rather than adding to, your customer base. But remember, the business is already in existence. If it's already affecting your existing operation, whether it continues operation in your hands or someone else's, the impact will probably still be there.

So how close is too close? It depends. You could have a location two miles away that's hurting your current business. On the other hand, even if the business you're interested in is only a few blocks away, it could be in a different trading area and may not have had any impact on your business to date. In addition, just because you have a unit *in* a mall doesn't mean you shouldn't own another unit outside the mall but close by — even right on the pad in the mall's parking lot. You may be drawing from a completely different population of customers.

Even given franchising's tendency toward duplication, your second site doesn't have to be an identical twin of your first unit. If you have a free-standing location now, perhaps a nearby strip center or a nontraditional site (such as a kiosk that sells the same merchandise you carry or in a food court) is a better choice for your next purchase. (Turn to Chapter 7 to find out more about nontraditional locations.)

Under the FTC Rule, unless a franchisor includes information related to unit sales and financial performance in its disclosure document, it is generally not allowed to provide you with any information about the financial performance of its franchises. However, this restriction generally doesn't exist when you buy an existing franchisee's business or when you buy a company-owned location from your franchisor. The seller of an existing business can provide you with any operating information you need. You can, and should, always ask to see the actual operating results and other information for the location you plan to buy. See Chapter 4 on financial performance representations.

Retrofranchising: Buying a company-owned location

Often, franchisors own locations they operate themselves. Sometimes the franchisor will build locations with the intention of operating them for the long term, and sometimes they build locations so they can sell them to prospective franchisees. It's also not unusual for a franchisor to obtain locations from franchisees who have left the system.

Retrofranchising is often good for both the franchisor and the franchisee. After all, the location is up and running, and you can see its track record and performance. Often, if the franchisor doesn't want to operate company-owned locations, it may be willing to sell these businesses at a discount — or finance some of the acquisition costs if the franchisee is willing to invest in additional locations. For the franchisor, it gets to use the proceeds from the sale of the business for other company needs.



TIP

Make sure you look at the financial performance and ownership history of a location. If it was a bad location in another franchisee's hands — and if your franchisor has a habit of flipping bad units from one franchisee to another — even your great operational skills won't magically turn a failing business into a success. But if the new franchise is obtained at a discount from what the original franchisee paid, the buying franchisee's loan payment would likely be lower than the original franchisee's was, and even with no change in sales, the buying franchisee should have an improved financial position.

Converting a competitor's location



TIP

If you're looking in your market area for expansion opportunities but no sites fit your needs, check out your competitors' locations. Acquiring an existing location from a competitor that meets your requirements lets you find a site and knock out the competition in one fell swoop.

Sometimes making a decision about this type of opportunity is simple. A lot of independent operators feel like David up against Goliath when franchises charge into town. If franchising is working right, the powerful name recognition, national advertising, and lower prices (thanks to a franchise system's buying power) you enjoy as a franchisee are already pushing the competitor's customers in your direction — and increasing the likelihood that the competitor may close.

Buying a competitor's site is another case where you don't start from ground zero. Hopefully, you can pick up the competitor's customers. You may be able to retain, but retrain, some employees. Making the transition, though, isn't easy. Because the competitor's location probably has a different design than units in your franchisor's system, you will probably have to remodel the location to meet standards. You may have to hire an architect and a contractor to make the changes. If the

location was being used for the same type of business, zoning probably won't be a problem, and your cost for developing the location should be lower than that of building a new location — after all, the building is up and electricity, water, and sewage are already in place. To convert the location to your system's brand, you will likely be changing the layout, hanging new signs, changing the décor, and adding new equipment.



TIP

Ask your franchisor's real estate and development department to work with you on this project. These professionals can help you determine whether the savings you expect from buying an existing location are likely to happen. For example, the site may have plumbing, but it may be in the wrong place, and you will have to move it. The site may have electric service, but it may not be sufficient for your needs. The building may be zoned correctly, but it may not have enough parking spaces. Seeking assistance before you make your purchase helps you work out these potential issues.



WARNING

If you're buying a location that has been operating under a different franchisor's brand, consult your attorney to make sure you can acquire the location without violating the other franchisor's rights or the seller's lease; some leases have limited permitted uses. The existing operator's franchise agreement may prohibit or hinder the sale. Your lawyer will help you through the process, but you want to make certain that you are even able to speak with a franchisee of another franchise system to avoid any complications. Ask the existing business owners to provide you with a letter providing you with the necessary assurances that their franchise agreement allows them to transfer the unit to you. This can help you avoid any claims that you've wrongfully interfered with an existing business relationship that the other franchisor may want to spring on you later. Your own lawyer will be your best guide.

Confirm with your franchisor that your franchise agreement lets you expand and that the new location won't encroach on another franchisee's territory or — in the franchisor's opinion — negatively affect sales at your existing unit.

Acquiring an area

If, from the start, you have big dreams of being a franchise tycoon, you may want to consider franchisors that offer the whole package: *area development rights*. These rights allow a franchisee to expand exclusively within a specific territory, according to a schedule — x number of units within a certain time period. In a twist known as *master franchising*, some chains sell an entire territory to a franchisee and, based on a schedule, allow the franchisee to open units or sell unit franchises to other operators, called *subfranchisees*.

The master franchisee recruits new franchisees into the system and often provides them with many services other franchisees get from the franchisor. In

exchange for recruiting and supporting the subfranchisees, the master franchisee retains a portion of the initial fee paid by the subfranchisee (the *franchise fee*) and retains a portion of the continuing royalty payments (the continuing fee paid by the unit franchisee to the franchisor, usually based on a percentage of gross sales). The arrangement has been common in international franchising but is becoming less so; it's never been very common in the U.S. Technology allows many franchisors to support international franchisees directly. (Chapter 16 covers international expansion.)

Some franchise systems expand primarily via area development or multi-unit development. Theoretically, by dealing with fewer but larger and presumably more sophisticated franchisees, franchisors can manage their systems with more ease and focus their efforts on support, new products, services, and other areas besides franchise sales. Other chains use a multi-unit strategy only in their core or larger markets and sell single franchises only in their smaller markets. The method depends on the system and its growth strategy.

For franchisees, an advantage of acquiring an area is that you lock in a territory in which you can develop multiple locations without having to worry about how many other franchises are being developed and how close those locations are to your sites. In contrast, if you buy franchises one at a time, you risk getting closed out of parts of your area because other franchisees or company-owned locations have been developed.

Before striking a deal for area development rights, consider the following:

- » The number of stores you ultimately want
- » The amount of money you can invest or raise to develop those stores
- » The number of locations the market can support
- » The additional costs and savings you will incur
- » Your ability to manage multiple units

Be prepared to pay substantial money up front. Area development rights typically command either a flat fee — which could be hundreds of thousands of dollars — or a fee per franchise you commit to develop. For example, if the franchise fee is \$40,000, you may be required to pay over the entire franchise fee for the first unit and a \$15,000 or more deposit on each additional one; the remainder would be due upon opening, when the lease is signed, or per the terms of your development agreement.



REMEMBER

If you default on the development schedule, you may lose your deposit — plus the franchisor may terminate your exclusive rights or all the development rights you were granted to the area.

Find out how strict the franchisor is regarding defaults of development obligations. Some will amend the agreement to accommodate late construction schedules or other problems. They may also extend the opening date. (Sometimes they charge the franchisee an *extension fee*.) The development schedule may also include grace periods. Many franchisors don't have a set policy — how they respond depends on whether the franchisee has been trying to get the units open and whether, despite their best efforts, unforeseen obstacles have arisen. The flexibility of the franchisor may depend on whether there is a good franchisee-franchisor relationship. Check with other multi-unit franchisees to find out what the franchisor does in a crunch.



REMEMBER

A policy can be changed, and if what you expect to happen isn't covered in your agreements, the franchisor likely is not required to extend that policy to you when you need it.

Franchisors often offer a lower initial franchise fee and sometimes a lower royalty rate to an area developer than to a franchisee who's only committing to open one site. There are three main basic reasons they offer reduced fees:

- » **The franchisor reduces costs by having one individual or company own multiple locations.** The franchisor saves on having to recruit additional franchisees to open units and on the time, cost, and effort of providing initial support to individual units.
- » **The franchisor provides a different level of support to the multi-unit operator.** With a multi-unit developer, a franchisor works with only one franchisee for all locations. Often that means it can support the locations differently than for a single-unit operator, reducing support costs.
- » **The franchisor recognizes that the multi-unit developer makes a commitment to the system and takes a sizable financial risk.** Both franchisor and multi-unit developer feel that the commitment should be rewarded in some fashion — usually in lower fees.

The amount of the initial and continuing fee discount depends on the franchisor, the number of locations being committed to, and the time it takes to get the units up and running. Franchisors usually limit any fee reduction to the initial franchise fee, but today it is becoming more common for them to consider also reducing the continuing royalty rate.

Make sure the development schedule is reasonable. If it's not, and if you need to negotiate later with the franchisor for an extension of time, you may find that you have to make certain concessions, such as a reduced territory.

- » Obtaining a successor franchise
- » Deciding how and when to depart
- » Putting the business up for sale
- » Moving on

Chapter 13

When the End Is Nigh

It may seem odd to talk about ending the franchise relationship, but when you become a franchisee, it may not be for life. In this chapter, the franchise agreement you signed so many years ago to operate your business under the franchise system is coming to an end, and you have some choices to make.

Assuming you have enjoyed your relationship with your franchisor so far, one of your options may be to continue operating your business as part of the franchise system. Should that be your decision, most franchise agreements will require you to notify your franchisor months in advance that you want to continue to operate your franchise for another term. We call that a *successor franchise*.



REMEMBER

Your current franchise agreement will spell out a range of months in which you must notify your franchisor, so pull out your franchise agreement a few years before your term ends because it's important that you don't miss your notification window.

Another option may be to simply let the relationship expire. Franchising does not have to be forever. Unfortunately, every business is not successful, and yours may no longer be providing you with the income you need, and in fact, it may have simply failed. If the reason the business has failed to perform is because you couldn't operate it well (and that is a hard self-assessment to make), you might still consider signing a new franchise agreement if there is a realistic opportunity for you to sell the business to someone who believes they can operate it better.

Decisions, Decisions



WARNING

Be careful how you make your decision about what to do when your term is ending. In addition to likely being required to pay a renewal fee, your franchisor will generally want you to bring your business up to its current standards. That might require you to make a substantial additional investment. Don't assume you will recoup your entire investment if you upgrade the franchise. Work with your accountant and other advisors in making this type of decision.

Sometimes the decision to leave may not be yours. Although you may believe you have the right to enter into a new or continuing franchise agreement, that may not necessarily be true. Your franchisor will, in most situations, also have some choices to make if you have not been a solid franchisee during your existing term, have not been paying your royalties, or have been violating other aspects of your franchise agreement. If that is the case, your franchisor may not want to extend the relationship with you. In some situations, you may not even have any successor rights, and the choice to continue — of course, subject to the law — may totally be in the franchisor's hands. However, in a few states there are laws that limit a franchisor's right to not renew your franchise. Working with a qualified franchise lawyer or consultant is essential in advising you on the impact of these laws.

But in most situations, you may be choosing to leave the franchise system because you want to and not because you have to. Your reasons will vary. If your franchisor's brand is wildly popular, or your business is wildly successful, selling out while the value of your business is high may offer you a great opportunity.

Or the reasons may be more mundane. Perhaps your spouse or significant other has received a great job offer out of state. Maybe you simply miss your grandkids who live in another state, and selling your business so that you can live closer to your family is the right life choice for you.

Perhaps, even when the business is financially successful, you are simply just tired of it. You have rolled one too many bagels, heard one too many complaints from customers, or butted heads with the franchisor one too many times — and it is just time to do something else. Whatever your reason, ending the franchise relationship does not have to be as ominous as it sounds. It could be a new start for you.

When you signed your franchise agreement, you most likely did not obtain the right to run your franchise indefinitely. Under the franchise agreement, a franchisee obtains the right to use a franchisor's brand and system for a specific period of time. Depending on the terms of the franchise agreement, the franchisee's rights to operate under the brand and system may last 5, 10, 15, or even 20 years. The clock usually starts ticking on the day the franchise agreement is signed, but, depending on the franchisor, might begin when the location opens for business. If the latter is the case, your franchisor gave you additional time to amortize

your investment by not counting the time you spent in finding and developing your business prior to its opening. It is not usual, but it can be a great benefit to you as the franchisee at the time.

At the end of the term, you have some choices to make:

- » **You can leave.** If you don't want to continue running the franchise, you can simply thank the franchisor for the opportunity and move on. You will be giving up the right to operate a business under the franchisor's brand, and the franchisor may resell the rights in the market to a new franchisee. You likely will be able to sell the building (if you own it) or any equipment or other assets so long as they are not proprietary to the franchise system. The franchisor may also elect to exercise an option (if granted to the franchisor under the franchise agreement) to assume the leases for the premises and equipment. Or purchase all or certain of the assets of the franchisee's business at a predetermined valuation or based on an appraised fair market value.
- » **You can sell.** You may choose to sell the business to another person. But remember, your buyer will need to first be approved by the franchisor to operate the franchised business. In addition, the franchisor may require the new franchisee to sign a new franchise agreement, and in some situations, the franchisor may have some say over the amount the new franchisee pays you for your business.



TIP

Generally it is to your advantage if the franchisor is willing to grant your buyer a new franchise agreement, because you may have only a few years left on your franchise agreement and a new franchisee will likely pay more for your business if they have a longer period in which to operate it.

On occasion, a franchisor may have a say over the price you set for your business's assets. If the price paid by the new franchisee concerns the franchisor because it reasonably believes the new franchisee won't be successful given the amount of debt they will need to service, the franchisor may disallow the sale at that price. If that is the case, your options may include reducing your selling price. In some instances, the franchisor may be satisfied if your buyer simply puts up more cash and reduces the amount of loan they will be carrying.

- » **You can switch.** In some cases you may want to end the franchise relationship, but if you like the business, you may desire to continue to operate a similar business not identified by the franchisor's brand or system. You might even be considering joining a competing franchise and becoming identified by another franchisor's brand.

Unfortunately, in the majority of cases, this is not a viable option because typically you will be bound by a non-compete provision prohibiting you from operating the same or substantially similar business at your current location or near any other locations within the franchisor's system. Moreover, the duration of the non-compete provision generally extends a few years beyond

the expiration of the franchise agreement. As noted earlier, the franchisor may elect to exercise its option under the franchise agreement to assume the lease for the premises and/or purchase the assets of the business, subject to the laws in your state.

» **You can continue.** If you want to continue to operate your franchise for another term, expect some changes. In most cases, in order for you to obtain a successor franchise, you are required to notify the franchisor in writing of your desire to continue (generally the notification period is six months or longer). You will also be required to make an additional investment to bring your business up to the franchisor's current system standard for new franchisees, and you will be required to sign a new franchise agreement. The terms of that new agreement will likely be different from the terms contained in your existing agreement.

As always, make certain you review the new franchise agreement with a qualified franchise lawyer before you sign on the dotted line.



REMEMBER

Going for Round Two (or Three or Four): The Successor Franchise

This section covers the last of the options mentioned in the preceding section: obtaining a successor franchise.

Paying the successor fee (if there is one)

Some things don't change. Just like when you first made the decision to sign your franchise agreement, you have the same kinds of decisions to make again.

Every franchisor varies its approach to granting successor franchises. Many franchisors will grant you a franchise for the same number of years as your original franchise agreement, such as a ten-year original term with one ten-year successor term; others may be for a shorter period of time. How long and how many additional successor terms you have available to you is likely specified in your original franchise agreement. Check out the specific terms of the franchise agreement — don't assume that the brand is available for you to use for life.

Some franchisors don't charge any successor fee, but most do, and that fee may vary from franchisor to franchisor. Successor fees may be a flat amount ranging from several hundred to several thousand dollars. They could also be a percentage of the then-current franchise fee, and on occasion may even be the same fee charged to new franchisees.

Many franchisee advocates argue that there should be no successor fee because the franchisee isn't starting from scratch. The argument is that they have mastered operating the franchise, require no initial training, site selection, or inventory advice because they completed those steps a long time ago. In our opinion, charging a successor fee is fair. There is a commercial value to your continuing to use the franchisor's marks, and system and the successor fee reflects that the franchisor's intellectual property has value. Although they won't usually be much, the franchisor will also have costs.

The successor franchise agreement

Typically, the terms of the successor franchise agreement will be different than those of your original franchise agreement. After all, a number of years have passed since the original franchise agreement was signed and the franchise system and market have evolved and changed. In addition, the value the franchisor assigns to its system likely has increased with experience and over time. Finally, changes in the law and the standards and practices in franchising may also mandate revisions to the franchise offering.



REMEMBER

To avoid being blindsided by the changes, you should keep yourself informed about the franchisor's current franchise offering throughout your term. Because your existing agreement might — in rare instances — include provisions that limit the franchisor's rights to make certain changes, you need to seek the help from a qualified franchise lawyer before signing your successor agreement. Where capital will be required for things like modernization, you will also need to be financially prepared. So, understanding the costs involved in opening a new location will give you a gauge of what to expect should you need to remodel your current location.

Here are some of the more common changes you can expect to see between your current franchise agreement and the successor agreement offered:

- » Royalty and advertising fees
- » Territorial rights and restrictions
- » Alternative product and service distribution approaches adopted by the system
- » Remodeling or modernization requirements
- » New technology such as a point of purchase (POS) system, equipment, menu boards and signage
- » Training requirements
- » Supply chain and required purchasing arrangements
- » A change of focus to multi-unit developers
- » Other material changes to the business terms of the relationship



TIP

Whether or not the franchisor requires you to modernize your location at the expiration of your franchise, by the time you sign your successor agreement, it likely a good idea anyway to modernize your business to meet the system's current brand standards in order to stay competitive.



TIP

You may want to remain in the system, but you have the option of leaving. In most situations, the franchisor wants to retain you since finding and opening a new franchisee for your market can be expensive and disruptive. Understand that you may have some bargaining power available to you if the franchisor appears to be requiring excessive remodeling or updating. Some franchise agreements may also include a dollar cap on remodeling costs.

Before you sign your successor agreement, most franchisors typically will ask you for additional items including evidence that you can continue to occupy your business location during the new terms and that your insurance coverage meets the system's minimum standards. In addition, the franchisor will likely require you to sign a general release of liability of all claims under the prior franchise relationship in their favor. The purpose of the general release is to provide the franchisor with assurance that any claim you may have or might be able to assert against them is gone before you execute the new franchise agreement. If you are agreeable to signing the general release as a condition of obtaining a successor agreement, you can ask the franchisor to make the general release mutual. In most situations you should not expect them to agree to do that, but you have some bargaining chips to play, so it doesn't hurt to ask.

Changes that have sparked controversy



TIP

Though no one likes changes in an agreement just to continue a relationship that has worked for the past ten or more years, most of the changes the franchisor is requiring are necessary business decisions and less than controversial. But some can spark a heated debate between franchisor and franchisee advocates.

Dispute resolution

Dispute resolution has long been an issue because it involves the method used to resolve disputes, the state where disputes will be resolved, and even what types of methods will be used for different types of disputes.

Attorneys of all persuasions will vary on the benefits of submitting all claims to arbitration or to a court or a jury. Franchisors like the "home field advantage" and the practicality of their headquarters state being the agreed-upon venue. Franchisees would similarly prefer any dispute to be handled in their home state. Further complicating matters, some state laws require the franchisor to bring any lawsuit

in the franchisee's home state. Some franchise agreements also incorporate a requirement for mediation as a pre-condition to any arbitration or litigation proceeding.

Consulting with a qualified franchise attorney will be important in order for you to understand the ramifications of these provisions. This is especially true because most franchisors won't negotiate dispute resolution provisions.



TIP

You won't find it in many franchise agreements, but several franchisors have adopted an ombudsman approach. An *ombudsman* exists within a franchise system to help facilitate the resolution of disputes before they escalate into full-on litigation or arbitration. These programs can be effective if they are set up and managed properly. Even if your franchisor doesn't have an ombudsman, you might request that it agree to using a third-party program like the one set up by the International Franchise Association (see <http://franchise.org/self-regulation-ombudsman>).

Supply chain rebates

As part of their mix of continuing revenue, rather than rely simply on the continuing royalty, many franchisors earn income through the system's supply chain. Where the franchisor is selling directly to the franchisee, as you will find with any other supplier, the wholesale price they set will include a markup to cover their costs and make a profit. The amount of the wholesale price is frequently an issue because the franchisor may be the sole supplier, and it sets the prices to be charged to the franchisee.

Many franchisors also receive rebates or commissions from suppliers based on the purchases made from that supplier by the franchisees. The right to receive rebates, commissions, and discounts from suppliers will be disclosed in the franchisor's FDD in Item 8, and the franchisee may be required to purchase only from suppliers authorized by the franchisor. As with the markup on products and services sold directly, the rebates received from the suppliers will usually be revenue to the franchisor, although in some systems the rebates may be shared with the franchisees or contributed to the system brand fund. How the franchisor is earning revenue off of the supply chain may have changed from when you signed your initial franchise agreement, and that change could impact your cost of goods.

Territorial rights

Ten years ago, when the franchise system was newer, the franchisor may have provided you with an exclusive market area around your business. This might have been because the franchisor didn't know the size of the territory needed by

the franchisee, or because the franchisor believed that in order to recruit franchisees, it had to provide an exclusive territory. Times have changed.

Consider the difference between a nonfranchisor, like Starbucks, that places its locations most convenient to its customers, and a franchise system restricted to where it can put locations because of territorial restrictions provided in franchise agreements. Franchisees prefer territorial protection, but the franchisor is seeking critical mass and exclusive territories that were set years before hamper that capability. That's why your exclusive territory may have vanished in total or the franchisor may have instead converted it to a protected territory in your new agreement. Even where territorial rights of some form are still provided, the size of that territory may have changed.

Alternative distribution

Nontraditional locations include venues like airports, university campuses, hospitals, sports arenas, convenience stores, and other locations where consumers may purchase your product or service but you were not the reason they went there in the first place. We call those mass-gathering locations. Also franchisors, like most businesses, have discovered the power of the Internet to sell their products and services — and the Internet is not local, but global. E-commerce may not even have existed when you signed your last franchise agreement. More than likely, even if you still have some territorial rights, you will find carve-outs removing mass gathering and the Internet from your territorial rights.

If the franchisor obtains significant revenue from e-commerce, and the online sale of products and services are significantly affecting your walk-up business, you may want to discuss receiving some benefits from the franchisor's e-commerce business — either in the form of referrals, access to national account business, marketing assistance, or a portion of the sales made to customers in your market. Be sure to ask, but understand that your franchise was likely limited to the business derived from your location, and Internet sales, though they may impact your business, are made outside of where your business is located.

Where the Internet may have an impact on your sales, talk to the franchisor about developing additional training and support of a retail theater approach to your brick and mortar location. *Retail theater* is a relatively new but effective approach that companies use to integrate Internet sales within their brick-and-mortar locations. No matter how impactful the Internet has become, there is nothing as powerful as a great human salesperson when coupled with the technology of the Internet and the knowledge of how to use it effectively in their business. Michael Seid, your friendly co-author, works with MSA's retail and manufacturing clients in developing and executing the retail theater approach.

RETAIL THEATER

When executed properly, retailing is no more than theater designed to engage consumers and deliver successfully on a retailer's brand promise. Consumers are overwhelmed with choice today, and although price and convenience have become the simple hallmarks of the electronic merchant, it is the ability of the brick-and-mortar merchant to make a connection and engage with the shopper in real time that is their most effective and competitive tool. Creating an environment that attracts customers into your store is essential, but what is most important is to keep them wanting to return as buyers. *Retail theatrics* — delivering the retail experience with the unique excitement that only a live presentation allows for — provides the buyer with an informative and differentiated experience in which the entire cast, the merchant and the consumer, are part of a very scripted but impromptu interactive retailing play.

Customers don't seem to be following the old retail rules any longer. The rule has always been that if you put a store in a high-traffic area, with good visibility, great signage, and a few strong anchors drawing a similar customer profile, customers will come. Provide them with friendly customer service, and they will buy. Retailing was a lot easier before the Internet. Amazon has become the everything store, and it is expected that soon it will carry more than 80 percent of what we buy — at better pricing and with better delivery than most brick-and-mortar stores can muster. The Internet has opened up the world of non-*geographic retail* — a retail world without a need to visit physical stores. Your challenge as a brick-and-mortar retailers is to make visiting your location a compelling necessity instead of enabling your customer to buy at another retailer or e-tailer.

Have you visited an Apple store recently? The greeter not only can confirm appointments and wait times at the Genius Bar but can also directly communicate with staff and call them forward to meet with you to discuss what you're shopping for. You can purchase most Apple products at Best Buy or online, but why would you? There's an excitement about the interactive experience at Apple. In addition to associates with extraordinarily deep product knowledge, there are tables full of products you can try out, and like a Disney Store, there's an area with iPads that children can play with while you shop. You can research products online and schedule to pick them up at the local store. You can book time online at the Genius Bar and get updates on the time of your appointment. And rather than simply sell the customer a MacBook Pro or iPhone or iPod and have you wait on line at a cash desk, they bring the cash desk to you in a handheld credit card reader. Want a printed receipt? No problem. Rather have it emailed to you? That's Apple's preference anyway because they can capture your contact information and keep you informed later about new products and features. Having the sales associate bring the cash desk to the customer is becoming more and more common with theater retailers, and even brands like Hertz are doing it today. Learning about becoming a retail theater instead of just a location allows bricks-and-mortar locations to remain competitive in an e-tail economy.

Bowing Out at the Right Time

The franchisee opens the store at 10 a.m. sharp, hires more employees to service the evening customers who pick up their vitamins or get their hair cut after work, and insists that their employees greet the customer within 20 seconds of entering the door. The franchisee does these things for a reason: timing. Running the franchise according to the clock makes sense. The same goes for selling it: There are right times and wrong times to exit. The timing depends on inner and outer forces, including your personal situation, professional aspirations, the franchisor, and market changes.

There's nothing wrong if you decide to exit your franchise, but keep in mind that the buyer of your business is going to want to know why. The reasons you give can impact your selling price because if the prospective buyer senses urgency, they may try to get you to lower your price. If a prospective buyer understands that the franchise system and your industry are flying high, the buyer may pay a premium for the privilege of entering the franchise system.



REMEMBER

If the franchisor is granting your buyer a franchise agreement with a full term, that may be a significant advantage to you in selling your business. Talk to the franchisor in advance of putting your business up for sale so you can position your business appropriately.

Getting personal

If stress or, ultimately, burnout is having a significant negative impact on you, what can you do to rejuvenate yourself? Maybe taking a long vacation to recharge is what you need. When was the last time you spent some time alone with the family? Are changes needed in your personnel or the culture at your location?

A bad reputation will spread faster than a good one. If you're burned out or have outgrown the business, it makes sense for you to exit before the business and, subsequently, the resale price begin to suffer.

On the other hand, maybe the economics of your business is changing or you see a new opportunity or want to relocate or retire. Here, financial factors are likely more critical, and you need to get the most when you sell. Maybe you anticipated retiring in five years, but an unsolicited and incredible purchase proposal presents itself. That may also be reason enough for you to sell now.

Examining your world

Begin by assessing the economy and the trends for your business. Good economic times and having positive market trends are conducive to selling at a higher price. When interest rates are low and financing is plentiful, more prospective buyers come forward. Can you afford not to take the right offer? Maybe with the proceeds from the sale of your existing business, you can relocate to a long-desired location and invest in a new franchise. Or maybe you can take the proceeds and invest in development rights for multiple units from your existing franchisor.

Assessing the local market is also critical. Are new businesses coming in to your area? Is the area undergoing revitalization? Is the landlord making improvements to attract new tenants and customers? If the answer to these questions is yes, that could bolster the price of your business. In contrast, if the surrounding neighborhood is starting to look shabby and the landlord is leasing to less desirable businesses, you may have missed your best opportunity to exit at a higher valuation.

Then you need to look at the industry itself. A thriving industry could mean a lucrative sale price. A franchisee may want to cash out before the market is saturated, a fad fades, or new technologies make the business obsolete. Even with a retail theater approach, consider how technology has impacted the way customers shop and what they are shopping for.

What is the state of your franchise system? Although you conducted your due diligence on your franchisor when you first came on board, things may have changed — for the better or for the worse. If same-store sales are starting to get soft because new and innovative competitors are entering the market, maybe the time is ripe for you to exit. If instead you believe the franchise system is and will continue to be a leading market competitor, you may want to keep operating and even expand development plans to include more units.

Some red flags that worry prospective buyers include the following:

- » Franchisee lawsuits
- » Negative press
- » Uncontrolled system growth or unprecedented franchise closures
- » Sagging system-wide sales
- » Unacceptable changes to new franchise agreements
- » Management shake-ups
- » Some other company acquiring the franchisor

Leaving It to Your Children

Little Johnny has swept the floors at your store since the broom was taller than he was. Little Jane has stuffed marketing coupons into envelopes since before she could write a complete sentence. Sound familiar? It should. Your co-author Michael Seid began to work in his family's business packing shelves and learning the trade before starting first grade and the family store was like his second home. His experience is not at all unusual.

Have you given any thought to your children not just as helping hands but as potential successors to your business? Growing numbers of franchisees have that very mindset and take steps to create estate plans based on a franchise relationship that will be passed down to a franchisee's children and heirs.

Children who have worked hard, love the business, and have helped build value may be ideal successors to your business and may be attractive as franchisees to your franchisor. Like any parent, many franchisees probably think that their kids can do anything. But keep in mind that because your business is part of a franchise system, your franchisor will need to feel the same way about your kids if your children are to assume your role.

Franchisors normally reserve the right to approve a transfer of ownership — even to family members. If an owner dies or becomes permanently disabled, some franchisors allow assignment of the franchise to a spouse or heirs without prior approval. More typically, franchisors require approval of the proposed successor franchisee within a certain time period, usually within 6–12 months. Some franchisors waive the transfer fee for these transfers.



TIP

Next-generation approval criteria are generally not described in the FDD or franchise agreement, so you should inquire in advance about the franchisor's requirements to approve a transfer upon your death or disability.

Gradually acclimating a son or daughter to the franchisor may also help. Take the child, at an appropriate age, to franchise conventions and training, for example. Many franchisors have developed “next gen” programs for the children of franchisees. Talk to your franchisor about its next gen program. If you're thinking of transferring your business to the kids, it likely is a good idea to enter them into the program early.

Smoothly passing a family business upon your retirement or death requires planning. Don't assume that the franchise will be part of your estate. You need to discuss this with your franchisor and examine it with a qualified franchise lawyer and accountant. Know your rights. Ask a few questions:

- »» What are your rights to transfer the business?
- »» Are your children and spouse acceptable to the franchisor?
- »» What are the criteria for the franchisor to approve the transfer, and can you get approval in advance?
- »» Does the franchisor have a next gen program?
- »» How much time remains in the initial and renewal terms of the franchise agreement?
- »» What form of agreement will you be able to transfer — a full new agreement or something less? If it's a new agreement, what are the changes from your current agreement?
- »» What renewal options are available? Who has to execute them to get the most benefit?
- »» Does the franchisor have a right of first refusal to buy the business if you try to transfer it, and will the franchisor waive those rights in advance?

It bears repeating that transferring a family business has serious financial, legal, and tax consequences. Before handing over the reins, you will need to develop an estate plan, which includes the current fair-market value of the business, and a succession plan.



TIP

Consult with accountants, estate attorneys, investment advisors, insurance agents, and family business consultants. The franchisor may offer succession-planning advice. Nationwide, about 100 family business centers affiliated with universities provide education on family business topics. For programs near you, ask your lawyer or contact the IFA's Franchise Education and Research Foundation at www.franchise.org/educational-foundation.

Letting go of control of your business is often difficult for many to accept. Upon succession, your children will likely still have to go through training and learn from their own mistakes.

Selling Out

If you want to stop operating your franchise, you should consider how you will benefit from all of the sweat equity — and real equity — you have pumped into your business. Value is there, and you should reap it. Every franchisee has the right to maximize the value of their business during its term based on the terms contained in the franchise agreement.

Smart franchisees orchestrate their exit strategies meticulously, from the overture to the finale. As with passing on the franchise to your heirs, selling your business requires a similar plan — including devising a personal business plan and targeting when and how you will exit the business. In this way, you can continue to have one foot firmly in your business while the other foot is inching towards the door.

Beginning to prepare several years before the target date makes sense. You will want to take steps to boost the value of your business, and doing so takes time. You need to investigate and then select an appropriate sales vehicle. Possibilities include using a sales broker, putting the unit in the franchisor's resale program, and networking with other franchisees.

After putting the franchise up for sale, it may get swept up right away — or it could take weeks, months, or even years to sell. Of course, as we have noted, the franchisor will have a role approving certain aspects of the proposed sale, especially as it relates to the proposed buyer who will be the new franchisee.

Sprucing up the joint: Getting the most return on your investment

Selling a franchise is very much like selling a house, and that even includes staging. Obviously, you don't have to light a fire in the fireplace or fill the air with the aroma of freshly baked apple pie. But you want to make your business look, feel, and be at its best before potential buyers cross the welcome mat. Clearly, what you put into the selling process affects what you will get out of it.

The first place to start is your finances. Without question, a prospective buyer's biggest concern is your business's financial bottom line. Is the business profitable? The only way a franchisee will know this information is if your books are in tip-top shape.

Allot at least three years of lead time to start keeping accurate records. By *accurate*, we mean removing personal expenses like the Porsche, artwork, and other personal assets used to minimize taxes off financial statements. Those expenses should not be there in the first place, and of course you would never do that. Nevertheless, the books should reflect only the business's true expenses and revenues.



TIP

Set up records by using generally accepted accounting principles and consider having a certified public accountant prepare financial statements for the business. Try to settle any financial obligations, liens, and claims or lawsuits with suppliers, customers, or other parties. Also, talk to an accountant and attorney far in advance for financial-planning purposes, such as setting up charitable trusts, to account for any post-sales tax.

Have your other papers in order, too. Prospective buyers see value in such things as business plans, employee records, supplier contracts, operational diagrams, and, of course, organized franchise support materials. Keep all the franchisor-provided operations and training manuals, as well as any additional information that may come in handy to the buyer, such as materials from seminars or conventions, surveys, the title, and environmental information.



WARNING

You're most likely under a confidentiality agreement with your franchisor. Check in advance about which documents you can share and which you can't.

Prepare a list, provide that to the prospective franchisee, and consider having them obtain access to that information directly from the franchisor. The franchisor is going to want to meet the buyer before the sale closes anyway, so clearing that hurdle early may make the sales process go more smoothly.

Next, cosmetic changes may be in order. The business already may be in good shape because you were required to meet the franchisor's standards during the franchise relationship. Still, any business could probably use some spit and polish in some nook or cranny. You should become your own worst critic. Attack things that a customer — and therefore a buyer — would see. Low-cost, routine maintenance pays off here. Consider getting new blinds, paint some walls, and straighten the pantry. Small improvements can have significant benefit to what you get when you sell your business.

Bigger investments take more thought. For example, should the franchisee upgrade equipment or remodel to meet the franchisor's current standards? Or should you let new the franchisee deal with — and pay for — these modifications? Will the investment or non-investment impact the sales price or the sale? Will the franchisor require modifications to be made as a condition of transfer of the franchise to the buyer?

In the end, much of the prep work in buying a franchise pays off when selling. Site selection was a chore, right? Here's the payback: Many buyers consider physical location a primary factor in determining value. Real estate leases that have several years remaining and renewal options are attractive selling points; leases on, say, obsolete equipment are not. Remember how much time you spent on employee training? Focus on having the prospective buyer be impressed by your trained staff so they'll want to keep some of your employees. How about customer loyalty? Supplying the buyer with access to customer contact and marketing data gives the buyer a big head start.

One legitimate concern of a buyer is whether the selling franchisee plans to open a similar business nearby in the near future, potentially competing against the buyer. The point is moot if the selling franchisee is bound by a non-compete agreement with the franchisor (and that is found in the franchise agreement). Otherwise, you can calm the buyer's fears by offering the buyer a similar non-compete

arrangement. You may also want to offer financing assistance or consult or help train the buyer for a specified post-sale period. These latter conditions tie you to the business a little longer, but can be compelling enough to close the deal.

Figuring out how much it's worth

At this point, you are wondering how much can you get for the franchise and how is that determined? Answering these questions is not easy. In the past, many business consultants and brokers were quick to rattle off formulas, usually based on a multiple of cash flow. Times have changed. Consultants and brokers realize that too many factors go into valuing a business to rely on a cookie-cutter formula. Every business has to be valued by itself.

Here is another reason why cookie-cutter formulas or so-called “rules of thumb” don’t work. Say the valuation is based on gross sales. There is a huge difference between a business that has suffered a downturn in sales — say, going from \$1 million down to \$500,000 — and a business that’s growing and generating sales, like going from \$250,000 in sales to that same \$500,000. There is also a big difference between a franchise agreement with 3 years remaining on it and one with 15 years remaining on it. These are just examples, but they are critical to understanding that a one-size-fits-all approach will lose the seller money or result in the buyer overpaying.

Valuations are based on the financial facts of the business, the current state of the industry, the business’s position in the industry, the location of the business, and timing. The key to valuation is that the numbers have to be accurate, and the ultimate value is based on cash flow, assets, and the return on investment anticipated by the buyer.

When franchisees transfer the franchise, many franchisors require the new franchisee to sign a new, current agreement but may not provide a full-term and renewal period(s) as it would for a new franchisee. The agreement is typically modified to provide only the remaining time and renewal periods unexpired from the original agreement. The difference between 3 and 15 years of remaining life can have a dramatic effect on the selling price.



TIP

Given the dramatic effect the remaining term of the franchise can have on valuation, determine the franchisor’s position on the length of time available to the buyer of your franchise. Franchisors often consider an early renewal, especially when only a short period of time remains on the franchise agreement, or they’re willing to provide the new franchisee with a full term.

You can ask the franchisor and franchisees what comparable franchises have sold for, but don’t expect the franchisor to help set a price. That could be a conflict of interest, especially if it has a right of first refusal to buy.



TIP

Having the business appraised is worth the expense. Seek out an independent, reputable third party that understands franchising to do the valuation. The cost of a valuation depends on the business being evaluated, including the condition of its records, the number of locations, and the purpose for which the appraisal is needed. Prices for a valuation can range widely. Figure that a valuation takes about 30 days and plug that into your exit timeline as well.

Again, as with selling a house, don't expect the asking price to be the selling price. Be prepared for negotiations, and be willing to compromise. Try to understand the buyer's motivations and view things from the buyer's perspective. We know that letting go of a business that you have put your blood, sweat, and tears into is tough, but being calm, rational, and friendly throughout the selling process usually pays off.

Playing by the franchisor's rules

As we mentioned earlier, when selling a franchise, the franchisee is not a free agent. Even if a buyer makes you a great offer, you can't formally accept it until certain details are worked out with the franchisor. Most franchisors have a *right of first refusal*, which means that whenever a prospective buyer makes a bona fide offer to purchase the franchisee's interest in the franchise agreement or business assets, the franchisor has the right to purchase it on the same terms and conditions within a set time period.



REMEMBER

Review the franchise agreement to see what rights the franchisor has reserved for itself, any requirements for notice to the franchisor of possible sale, the form of the notification, and how many days the franchisor has to respond.

In other words, the franchisor may end up buying the franchise. Many franchisees have a problem with this provision, and rightfully so. They feel that such a provision hurts or at the very least interferes with their sales efforts. Consider a sophisticated buyer who spends months checking out the franchise and makes an offer only to lose out on the opportunity to buy the business because the franchisor moves in, matches the price, and buys it right out from under them. Trust us — that potential buyer will not be pleased. Some sophisticated buyers won't even begin to negotiate or do their due diligence on the business if the franchisor will likely match their offer.



TIP

We recommend you discuss this issue with the franchisor and determine what its intentions are before beginning to market the business. If the franchisor decides that it is not interested in executing on its right of first refusal, get it in writing. Such proof will allay a potential buyer's fears.

Franchisees also need to deal with the franchisor's right to approve the transfer. Most franchise agreements give the franchisor the right to approve all transfers of

ownership. Think of a prospective groom asking the father of the bride-to-be for permission to marry his daughter before he asks for her hand in marriage. Some provisions add that the franchisor can't unreasonably withhold consent. The word *unreasonable* can be open to debate, however. Typically, a new franchisee must meet the franchisor's qualifications, fulfill ownership requirements, such as training and remodeling, and sign a then-current form of franchise agreement.

The franchisor also receives a transfer fee, usually to cover legal and accounting costs. Not all transfer fees are identical, so confirm the exact transfer fee applicable to your deal before negotiating the purchase price. For example, instead of charging a flat fee, some franchisors charge a percentage of the then-current franchise fee or even the sales price. Others reduce the fee if the buyer is an existing franchisee or an employee of the franchisor or franchisee. Transfer fees, training costs, and updating costs can be used in negotiations to affect the purchase price and timing of the deal, for either the selling franchisee or the buyer.

Expect the franchisor to ask you to submit the proposed purchase agreement and to take a look at the purchase agreement generally on these points:

- » Inconsistencies between purchase agreement and franchise agreement
- » Debt structure and leverage
- » Overall viability of transaction
- » Structure of ownership and operations
- » Condition of the facility and arrangements for upgrading or repairs



REMEMBER

You will need an attorney involved to assist you in structuring and documenting the sale of your business. The franchisor will also want to confirm a few items that directly impact it, including that

- » Monies owed to the franchisor and its affiliates have been paid in full.
- » You've executed a general release of all claims against the franchisor.
- » You've agreed in writing to comply with all post-sale obligations under the franchise agreement, including non-compete obligations.

Some franchisors recommend or mandate that the selling franchisee remain onboard for a period of time after the sale to smooth the transition to the buyer. Some franchisors require, subject to state law, the selling franchisee to stay on as guarantor of the buyer's performance under the franchise agreement. The need for such conditions and how well they work out may depend on the experience and skill of the buyer and the personality of the selling franchisee. It's always awkward to be asked to train or monitor your replacement, and the situation can be

more so if the buyer changes your tried-and-true methods for operating the business while you're still training.

On the plus side, in-house mentoring, consulting, or personal introductions to suppliers and customers by the selling franchisee are valuable and should raise the sales price. Buyers may view a willingness to stay on as a reflection of the selling franchisee's transparency. And the selling franchisee may gain peace of mind if the buyer is a gem, seeing that the business is in good hands.

Some franchisors are reluctant to get involved in the sale, especially regarding the selling price. If the selling price is high, and the franchisor objects, the selling franchisee may claim the franchisor interfered with the sale. On the other hand, if the franchisor doesn't tell the buyer that the price is excessive, and the buyer (as the new franchisee) is unable to meet the debt service on the business, the buyer may claim the franchisor should not have approved the deal later on. These scenarios can be troubling.

Many franchisors have worked out formulas concerning debt service-to-cash flow ratios, which they make available to their franchisees who may sell in the future. Although not guarantees, providing this type of guidance can avoid problems later on. Often if the price is high but the amount of cash the new franchisee is willing to invest keeps the debt service low, this will make an otherwise unacceptable deal acceptable.

Selecting a sales method

Okay, this is it. You are ready to let go. You are convinced the timing is right, you know what the business is worth, and you are aware of any obligations to the franchisor. All that is left is actually putting your business on the market.



TIP

We suggest that a franchisee not try to market it independently. Doing so is draining. It's best to leave the marketing and selling the business to a professional and concentrate on running it so you preserve the value of what you're selling. A logical place to start is to contact the franchisor. Because it typically has the right of first refusal, entitling it to buy the business, checking with the franchisor first makes sense. Selling to a franchisor usually yields the fastest, though not necessarily highest-priced, deal.



TIP

Stay alert for signs that the franchisor may be interested in buying your business when the time comes. For example, has the franchisor established a pattern of buying back units? Is it repositioning itself to operate more company-owned units? Is it looking to enter any particular market?

Another reason for contacting the franchisor is that it may offer a franchise resale program. This may be a formal program in which the franchisor will facilitate

introductions to potential buyers, or an informal program in which the franchisor generally stays informed about prospective buyers, including new franchisees who want to buy existing units or existing franchisees who want to buy more units. In either case, check to see whether the franchisor charges any fees in connection with the referral. The franchisor normally considers these leads qualified if they're in its database, which should speed the approval process along.

Here are a few strategies for shopping the franchise:

- » **Don't rely only on the franchisor to notify existing franchisees.** Contact the franchisee advisory council and franchise association if one exists (see Chapter 10). Put out the word on the franchisor's intranet forums and talk up the business at conventions and other meetings.
- » **Try marketing the franchise on a resale listing service on the Internet.** Be careful, though, because this sales technique also makes this information available to your managers and staff. Selling franchisees and brokers pay to post franchises and other business opportunities for sale over specific time periods.
- » **List the franchise with a *business broker*, the equivalent of a real-estate broker for businesses.** Use a business broker with a national and international network, because the buyer may not come from around the corner. If the business broker is familiar with franchises, all the better. Fees vary by location and sales price.

Now That the Party's Over

You have just completed life as a franchisee. Sounds like the beginning of a movie script. Well, most great flicks usually spawn a sequel. Now you need to write yours. Will Part II be more enjoyable, more adventuresome, more dramatic, more humorous? It can play out however you want it to. Of course, some franchisees may just want to pocket the box-office sales — take the \$100,000 or \$500,000 or however much they have made from their franchise — and head off to Cancun, indefinitely. But unless they are retirement age, most people get itchy after a while and are ready again to star in a more active role — that is, life after being a franchisee.

Reflecting on the experience

In order to look ahead, look back at the past. Rewinding the experience as a franchisee helps determine whether to do something similar or do something entirely different. So hop on the couch for another self-analysis session. Before buying

the franchise, you asked questions to see whether being a franchisee was the right move. (See Chapter 3 to refresh your memory.) Now, based on the experience, revisit those questions and see whether the initial answers really held up. This exercise helps determine what you have learned:

- » **Were you an entrepreneur or a “formula entrepreneur”?** Did it bother you to always be concerned about rules, standards, and consistency? Did you have to control many urges to do it the franchisor’s way? Were you devastated any time the franchisor flatly rejected one of your suggestions? Or were you thrilled that the franchisor had a proven system to follow and that it was leading the way?
- » **Were you really a people person?** Were you able to coach, motivate, criticize, teach, and praise employees? Or did you avoid confronting employees, disciplining, or enforcing the rules of your organization?
- » **Were you able to independently manage your business on a day-to-day basis?** Were you able to keep up the pace and work those long hours? Were you annoyed when you would get called back to the business for an emergency just when you were settling in to watch a Sunday football game? Did you pitch in and mop the floor with a smile on your face when an employee called in sick?
- » **How was your relationship with your franchisor?** Were you at loggerheads, or did things run pretty smoothly? Did you get involved with other franchisees and tap into the franchisor’s resources? Did the franchisor come through? Were you a good franchisee?

Making the next move

Football players have hung up their jerseys, lawyers have thrown out their law books, and doctors have put away their stethoscopes — all to become franchisees. No kidding. So, if a franchisee wants to be an ex-franchisee turned football player, lawyer, doctor, or anything else, they should go for it. Don’t be afraid to do something totally different (even without going through a midlife crisis). And just how should new plans be determined? Read on.

Considering the options

Based on your franchise experience, you may want to begin again in franchising. Here are some options:

- » **Becoming a franchisee of the same brand:** Maybe you want to relocate to another state or market, buy multiple units, become an area developer this time, or take the concept international.

» **Switching to another brand:** You could stay in the same industry or try a totally different industry. Perhaps you had a retail store before and now you want to try a service business that does not require as much overhead. Check any non-compete clauses before doing anything.

New beginnings also could include the following:

- » **Trading up to be a franchisor:** A handful of former franchisees have bought the very franchise companies they were a part of or have become franchisors of different systems. The insight they gained from being on the front lines proved invaluable.
- » **Working for the franchisor:** You may want to stick with the same franchise, but work on the inside — at regional or corporate headquarters, for example. More commonly, the reverse happens: Corporate employees become franchisees.
- » **Becoming a consultant:** The franchisee may want to compete with your co-author Michael and become a franchise consultant. (Michael was a franchisee *and* a franchisor before he became a franchise consultant, and now he is a franchisor and a consultant.) Depending on the number of years in the industry and any expertise, the franchisee may have a lot of insight to offer franchise neophytes.

Double-checking the old agreement before moving forward

If a franchisee learns one thing from the franchise experience, it is to always *check the rulebook*. Well, the rules are no different after having relinquished the title of franchisee. Before planning any next moves, go back to the franchise agreement to see whether any restrictions limit future plans.

Virtually all franchise agreements, subject to state law, have non-compete clauses in effect both during and after the termination of the franchise agreement. Post-term, the franchise agreement usually prevents the franchisee from owning or operating a competing business in a defined geographic area for a certain number of years. Two years is typical. The non-compete provision may cite specific businesses, industry segments, or whole industries. It also may cite specific distances from the original unit you operated, another franchisee's unit, or a company-owned location, or it may have a blanket restriction.

Whatever your long-term plans, whether you choose to stay the course and continue with your business, expand the business into different cities, or sell and go to Tahiti, the one underlying thing you need to remember is that if you do your homework on the front end, if you understand the franchise agreement, and if you plan for your future, you will have more options and probably a happier future.

5 Building Your Own Franchise

IN THIS PART . . .

Find out whether you and your idea have what it takes to qualify as a potential franchisor and how to get help.

Choose the right markets and recruit the right franchisees.

Take your show overseas — or not: how to know whether international franchising is right for you.

Discover how to apply the principles of franchising to social problems with social franchising.

IN THIS CHAPTER

- » Franchising your business: What are the chances?
- » Qualifying as a potential franchisor
- » Finding the help you need to get started
- » Launching your new franchise: strategic planning

Chapter **14**

From Small Business Owner to Franchisor

Before a single franchisee can exist, a franchisor must be born. In the next few chapters, we begin to explore what it will take for you to transition from running an independent business to becoming a successful franchisor.

Although an FDD and legal agreements are required to sell franchises, those documents alone are insufficient to make you a franchisor. As you've surely learned by now, becoming an effective franchisor requires more than simply meeting your regulatory obligations.

Don't rush out and engage an attorney to prepare your FDD. There are simply too many business issues to deal with first, and working with a lawyer is well down on the list of things you need to do. Your first step is to determine if you're even ready to expand — note we didn't say ready to *franchise*. Once you know if you're able to grow, then you can determine whether franchising is the right method of expansion for you to use. After that you can begin to determine how you should structure your franchise offering.

A single chapter is not going to tell you everything you need to know about conducting a threshold analysis of whether becoming a franchisor is the right approach or how to structure a franchise offering. But these next few chapters will give you a taste of what professional consultants like your co-author Michael Seid and his firm MSA Worldwide look for when designing and developing a franchise system.

Turning Your Small Business into a Bigger Chain

A mistake many emerging franchisors make is going initially to a lawyer and telling them to prepare their franchise documents. When properly prepared, franchise agreements and disclosure documents need to reflect the necessary, underlying business decisions and should only be prepared by lawyers after the strategy and business determinations have been made and validated. You should begin your work in developing your franchise system with experienced business professionals because most lawyers can't provide business advice with the professional rigor used by qualified business professionals.

Though you need an FDD to become a franchisor, don't confuse the ability to sell franchises with being a successful franchisor. Being able to sell a franchise is not an indication of much — selling a franchise is not all that hard to do. Any number of franchise systems have sold franchises and didn't survive past their third, fourth, or fifth year.



REMEMBER

Being the first to market with a franchise concept also has little to do with success. The market will always accept great products, services, and concepts that provide consumers with what they want in the way they want it. If you're new and innovative, if your product or services meet consumers' needs better than what's currently available, you shouldn't fear going to market.

Consider franchise systems like Firehouse Subs or Five Guys, which have emerged as leading franchise systems. When they first began franchising, the market was flooded with large, established franchise systems in the quick service sandwich and burger industries. What allowed them to compete effectively, even in what some called saturated markets, were outstanding products wrapped in an intelligent consumer offering that produced an attractive return on investment for their future franchisees.

Established franchisors and other large, established companies frequently suffer from what is called *incumbent inertia*. Incumbent inertia describes companies that feel so secure in their market position that they don't innovate because they don't fear small upstart competitors. How do you think the taxicab industry feels today in the world of Uber and Lyft? You get the point. The taxi industry had the necessary scale and resources to evolve but dismissed the newcomers and the needs of the consumer — and now companies like Uber and Lyft dominate the “driver for hire” market. Amazon continues to demonstrate the advantage of being an innovator and disrupter in the marketplace, and companies like Sears are quickly become a memory as they close once profitable stores.

In this section, we are also going to look at some of the benchmarks and criteria for determining whether your small business is ready to grow and whether it should do so using franchising.

Deciding whether your business should be franchised

In the United States, with the exception of states that require a franchisor to send in their disclosure documents for review, no federal or state agency ever has to see your franchise offering documents before you begin to recruit franchisees. Becoming a legal franchisor is really quite easy in most U.S. states, and outside the United States, having a disclosure document may not even be required.



PLAY THIS

You will find a summary of domestic and international franchise laws at www.dummies.com/go/franchisemanagementfd.

Technically, all you need to be a franchisor is an FDD that you can hand to a prospective franchisee two weeks before they sign an agreement or give you a check. You legally don't even need a consulting firm like MSA or a law firm like Gardere because in the back of certain magazines, next to the ads for instant seahorses and pills to help you lose 30 pounds without changing your diet, you'll see companies that will sell you blank franchise documents you can fill in yourself. They even sell boilerplate operations manuals.



WARNING

In franchising there are consulting firms and law firms that are called *packaging firms*. These are, for the most part, firms that use boilerplate strategies and legal documents to create franchise systems — as if one size fits all. As we discuss later, going that route can be very risky, not only for you but for any franchisee you recruit into your franchise system.

Answering the question “Can I franchise my business?” is easy. Regardless of what business you are in, you *can* franchise your business. Seriously, you can franchise any business. But “can I?” is the wrong question. What you need to know is whether you *should* franchise your business.

Putting the preliminary legal requirements in context

Because of the requirement in some states that requires pre-sale registration of a franchisor's disclosure documents, there is a perception that franchise laws are complicated and onerous. They really aren't, and with the aid of a qualified franchise lawyer, navigating through the franchise regulatory process is relatively simple.

Under certain states' laws, a franchisor sends its pre-sale disclosure document to a state regulator, which reviews the documents for compliance with that state's law. The state regulator doesn't opine about the quality of your franchise agreements, nor do they care whether or not your concept is based on a good idea. It is not their responsibility to determine whether your concept has been tested or whether the underlying business you are offering as a franchise has ever made a dime. That's not their job, although some states will require your financial statements to show that you have sufficient capital to fulfill the promises you have made in your FDD to prospective franchisees. There is no minimum standard in the United States for who can offer a franchise and, under the law, a franchisor doesn't even need to have any level of competence or experience in the business opportunity being offered.



REMEMBER

Think of franchise registration like an automobile emissions test. If you pass, you can drive your car on the street. Both a brand new Bentley and a 30-year-old Yugo take the same test. But passing that test doesn't mean they are equally good cars and, for certain, the emissions test doesn't even let you know if you have enough gas in the car to drive it down to the corner. All franchise registration means is that you can *legally* offer franchises in that state.

For most lawyers and other professionals, it's not hard to get a franchise system registered in most states. Therefore, before you begin to develop your franchise system, before you invest in the creation of brochures, before you invest in the creation of legal documents and hire franchise sales and support staff, it is only sensible and prudent to first find out whether what you have is franchisable.



TIP

It's also important that you assess whether you have put in place the requisite protections for your trademarks and other intellectual property, like manuals, recipes, and in some cases, patented equipment, products or other items. Sometimes an owner can lose valuable intellectual property rights if the trademarks and other intellectual property aren't protected properly under intellectual property laws. This is an area in which you should promptly talk with your attorney so you know your rights and the proper timing for obtaining the necessary protections. Whether you franchise or not, protecting your intellectual property makes good business sense.

Criteria for Becoming a Franchisor

As you can tell from Robert Cresanti's foreword to this book, MSA Worldwide, co-author Michael Seid's consulting firm, and Gardere, co-author Joyce Mazero's law firm, are very well regarded in franchising. The IFA described MSA Worldwide in its Franchise Opportunities Guide as "the leading strategic and tactical advisory firm in franchising." Joyce Mazero has been rated in Band 1 nationally — the highest ranking — for franchise law by Chambers USA year after year.

When MSA conducts a *threshold analysis* to determine whether a client is franchisable, it examines a broad spectrum of issues related to the business. The threshold analysis is a formal and systematic examination of a client's performance and readiness to become a franchisor. Professional franchise consulting firms, in one form or other, conduct similar feasibility examinations before they begin to develop a franchise program for a client.



WARNING

Be very wary of any firm that tells you that you should become a franchisor before they conduct a credible form of threshold analysis. Franchise packaging firms prey on a potential franchisor's pride in their business and eagerness to expand. Telling a client what they want to hear — that their business is obviously franchisable — can be amazingly compelling. Unfortunately, too many companies fall for that approach, and though the packager makes a hefty fee, the franchise system doesn't survive — because it really should never have franchised in the first place.

Although it takes discipline to know who should franchise, it's surprisingly easy to know which companies should not be franchising. For that we don't even need to test anything. Consider these red flags:

- » It's only a concept or an idea and the company has never opened and operated locations
- » The company only has a limited operating history
- » The company has not had a history of sustained profitability
- » The company isn't achieving a reasonable return on investment before factoring in franchise fees and costs

If any of these red flags pop up, then the business is not franchisable — at least not yet. Regardless of what your friends say, or even if a franchise packaging firm has told you that you're poised by your great idea to become the next McDonald's — if you see one of these red flags, stop. Chances are good that your company is not ready to franchise.

When a company is not yet even ready for MSA to conduct a threshold analysis, if there is potential, we usually recommend that they spend the necessary time to put their house in order. We recommend that they first operate the business for a while and gain the necessary experience before developing a franchise system. Having the necessary experience and a proven capability of operating a profitable business with a solid return on investment is not a lot to expect from any emerging franchisor.



REMEMBER

The bottom line is that your franchisees are not guinea pigs. Although there is no legal requirement, from a practical business vantage, it's important that you have operated the business profitably, and usually it's a good idea that you have done it more than once.

So, what does a firm like MSA look for in determining whether a business can successfully franchise its concept? That all depends on the business. As in most things, one size doesn't fit all. The following are some of the general criteria MSA uses in evaluating whether a company should expand and whether franchising should be included in the downstream expansion mix:

- » Economic reality of the existing business
- » Consumer demand for the product or service
- » Management's capabilities and commitment
- » Ability to recruit franchisees
- » Availability of the necessary classes and profile of franchisees



TIP

Franchisees come in a host of varieties and sizes. At a basic level there are single-unit and multi-unit franchisees. Dig a bit deeper and you'll find that multi-unit franchisees can be subdivided into various *classes*: franchisees that are looking to open multiple locations to earn income for their families, strategic franchisees that own other businesses and are looking for opportunities to leverage their back of house infrastructure, and investor franchisees looking for opportunities to include in their investment portfolio. These are just some examples. It's essential for a franchisor to understand the classes of franchise that will be attracted to its franchise system.

Other important criteria include the following:

- » Ability to systemize the system
- » Ability to train and effectively transfer the needed skills to a franchisee and their staff
- » Ability to localize the concept when needed
- » Ability of the business to differentiate itself from the existing competition
- » Level of capital resources available and required for the design, development, expansion, and management of the franchise system through anticipated breakeven point
- » Economics of the anticipated franchisor can provide the needed return on investment
- » Existence of licensing or regulatory barriers to effectively franchising the business



REMEMBER

These are only a few of the criteria you will need to examine, and each industry will have additional elements to be considered. You might have a successful business that still shouldn't be franchised. If, after imposing the necessary fees, the bottom line of the business can't pay the franchisee a salary, can't service the franchisee's

debt, and doesn't provide a reasonable return on a reasonable investment — it is just not franchisable. Many companies will still expand, but they generally will do so by opening and operating additional company-owned locations.

Do you have an operating business?

If you don't have an existing business that you have operated for a while — stop. Go ahead and develop one. Run your prototype for a long while; make sure it works. Make sure you understand its ebb and flow, seasonality, customers, suppliers, IT requirements, competition, positioning, and branding. You need to have an understanding of everything about your business. After you've developed one location, develop another one, maybe more, and if you can, do it in more than one city or in different types of markets or locations in the same city. Then come back.

You need to be able to define, at a minimum, the following from that operating experience:

- » Types of locations that work for your concept and those that don't
- » Interior and exterior design, décor, and signage
- » Construction costs and requirements
- » Business seasonality
- » Competition and competitive advantage
- » Brand promise to consumers
- » Initial and continuing marketing requirements
- » Operating expenses including rent
- » Labor and management requirements
- » Training requirements
- » Pricing strategies
- » Sources of products
- » IT and POS requirements

Will consumers need or want your products and services tomorrow?

To better predict your franchise's future, you must have a measurable set of results — that is, you have been in business for a sufficient period of time. Your success will depend on whether there is sufficient consumer demand for your

products and services. Ideally, you have based your business either on a well-established consumer demand or on a trend that will keep your company's products and services in demand for the foreseeable future. In addition, you want to operate in a technological environment that is beneficial to the concept's long-term success. Ask yourself these basic questions about your business:

- » Is it based on a well-established consumer demand or trend?
- » Can it distinguish itself from the competition?
- » Does it have a high return-customer base?
- » Does it own its trademarks and service marks?
- » Does it have a recognizable brand?
- » Is it seasonal, and what are the working capital requirements in the off-season?

Most any business can potentially lend itself to franchising, but historically, restaurants, retailers, and service providers have had the widest appeal. Here's some advice on deciding whether you can successfully franchise your concept:

- » Most restaurant concepts are good candidates, but those that need chefs rather than cooks or have intricate menus and recipes are more difficult.
- » Companies whose products and services have broad consumer acceptance are a natural as long as the market trends support long-term viability and growth.
- » Companies whose operating margins allow for franchise fees and still leave an adequate return on investment (ROI) for both the franchisee and franchisor usually are suitable for franchising.
- » Companies in fragmented industries (industries where most of the businesses are independent operators) that would benefit from brand consolidation are great franchising candidates.
- » Companies in a stable or growing industry, unburdened by significant regulations and licensing requirements, are normally franchisable.
- » Companies with systems that are simple to execute, that can draw from a large pool of qualified candidates, or that can train franchisees to use the technology in a reasonable period of time will work as a franchise.

Are you committed to franchising?

If you are going to be successful as a franchisor, you need to understand that you are entering into a new business that will require you to learn a new set of skills.

You can expect to also need to bring on board new management and sales personnel experienced in expanding and supporting a growing franchising system.



REMEMBER

In the early days, you can expect to wear many hats, and most small emerging franchisors don't add a lot of people to the payroll until they are needed. But being a franchisor is not a part-time job. Plan in advance so that you have someone you trust who can manage your existing business while you focus most of your time on your new franchise system.

Prospective franchisees are attracted to franchise a system whose management is experienced, ethical, and has a history of financial and personal accomplishments. You are more attractive to prospective franchisees if you can add sustainable value to the relationship, including product and service enhancements, management and staff training, operations manuals, field consulting, consumer marketing, multi-unit operations skills, franchise system expansion skills, and other support systems they have seen in other successful franchise systems. Therefore, the bios you include in your FDD about your management's background must show the potential franchisee that you are well qualified and know how to run the business you are franchising.

When you start a franchise, you need to be emotionally and financially committed and have the capability to make the necessary investments in the long-term growth and support of the franchise system. Your franchise system will need to have the necessary resources to adapt the system to local market conditions, evolve the product and service offerings, motivate franchisees to achieve successful operations, and enforce system brand standards. The organization you will develop must be ready to implement, support, and evolve the franchise system after you launch it. Simply drumming up the necessary capital to obtain your FDD and sales material is insufficient.



WARNING

Many franchise packaging firms will tell you that you can operate the business in the early days on the franchise fees you will be collecting. That is rarely true and even more so — rarely, smart.

After the franchisees come onboard, they expect you to deliver on the promises you made in the franchise agreement, and you will need additional capital to meet all of your commitments. Ask yourself these questions:

- » Can you and your existing staff operate and grow the business?
- » Can you afford to hire the additional franchise talent you may need?
- » Do you have the resources necessary to meet your commitments to your new franchisees?



REMEMBER

Having the right people in place to execute a franchise strategy is important. If all the help you can afford to hire are you and your spouse, and you're already running your business, you're in for some challenging times.

Great franchisors try to deliver all the support that their franchisees need to be successful; others provide very little. If you want to see your system grow, you should try to deliver a sustainable competitive advantage by continually providing local support and new products, services, and marketing that enable your franchise system to operate at the head of the pack for the long term. Try to answer the following questions:

- » What type of support programs do you need to put into place to assist your franchisees and to operate and grow the franchise system?
- » Can you put those systems into place yourself, or do you need outside advisors or resources to help you?
- » How will you provide continual training, field and headquarters support, marketing support, new product introduction, and all the other services required to make yours a great franchise system?
- » What about research and development? Can you develop additional products or improvements to those you currently offer, in order to keep your franchise fresh and your franchisees profitable?

Before saying you can do these things, be sure you know how you'll do them.



REMEMBER

Technically, everything you are required to provide your franchisees will be detailed in the franchise agreement. Keep in mind that your first franchisees will be investing in your concept largely on how much they trust in you and your capabilities. Later franchisees will have the ability to call your existing franchisees to find out how good a franchisor you really are. It is good practice to overperform, therefore, and do *more* than you may be required to do to ensure your franchisees are successful. It is not a legal requirement, but it makes good business sense to do so, since validation by your existing franchisees will make the closing on future franchise candidates not only easier but, in the real world, possible.

Do you have enough potential franchisees and do you know who they are?

Perhaps your family and friends keep telling you that you should start a franchise. They say everybody they know says so, right? But has anyone besides them ever told you that? Eventually, people outside your family have to step up to the plate and make the necessary investment in you and your business. Will they?

Before you develop your franchise, you should know something about your potential franchisees. What are the profiles of your prospective franchisees by class? When we talk about *classes* of franchisees, we're exposing you to the idea that not all franchisees are the same. There are single-unit franchisees who will own and operate the business themselves; there are independent businesses in the same industry that might want to convert to your brand; and there are multi-unit franchisees. In the most basic look at multi-unit operators you will find the investor that wants to open and operate several locations themselves, those that own other non-competing businesses and are looking for ways to leverage their existing organization into an additional business, and private equity and other groups looking to invest in your concept simply because they are looking for ROI. The investment bankers are not planning on getting behind the counter and serving customers anytime soon.

There are additional possibilities, but we say focus on these to start:

- » Who's going to be attracted to your opportunity? Are they the same people you want as franchisees?
- » Do you have an understanding of what geographic expansion strategy is appropriate, and what you can readily support?
- » Are your growth plans realistic? Can you support your new franchisees financially?
- » Does an adequate pool of potential franchisees exist — candidates who are ready, willing, and able to become franchisees?
- » Will your franchise system be attractive to only one class of franchisees, or will you be able to attract several types, including single-unit and multi-unit operators and investor groups?
- » Can you operate your existing business while you're developing and operating the new franchise system?
- » What happens when you begin to open in more than one market?
- » What happens when two or more franchises open in the same week? Can you meet your commitments to all the franchisees at the same time?
- » Will this be the type of franchise that people will be proud to operate?
- » Will prospects be able to afford your franchise?

We're not talking about simply affording your franchise fees and royalties, but everything, including site development, interior design, equipment, training costs, and working capital — all the costs required to get into the business. If your targeted prospect can't afford to get into the business, you have to either rethink and adjust who your prospect is or find a way to reduce the entrance costs.

You can't wait until you have begun to offer franchises to figure out the answers to the preceding questions, because if you do, you may find the following:

- » The pool of potential franchisees may not be sufficient to meet your expansion goals.
- » The pool of franchisees may be sufficient, but the pool has little interest in what you have to offer.
- » The cost of acquiring the franchises may be too high or take too long.



REMEMBER

The cost and timing of acquiring franchisees will affect your financial viability and, therefore, your franchisability.

Many of the articles and books you read about franchising try to lead you to believe that franchising is an easy and quick-growth strategy. It can be, but for most new franchisors, it is not as fast as they expected and it often costs more than they expected.

Depending on your industry and the investment range for your business, a typical franchisor opens fewer than ten locations in the first year of operation; the average is probably closer to five. Five to ten new locations in a year is still a pretty impressive growth rate for a new company. Given these numbers, you need to focus your efforts on achieving critical mass and sufficient market share to support your brand and achieve victory over the competition in the markets you do enter.

It is far better in the early days to have a regional growth strategy than to recruit franchisees in the four corners of the country. First, it is less expensive to support nearby franchisees. Second, you need to learn your new craft as a franchisor, and solving problems closer to home is far easier than doing so across thousands of miles and multiple time zones.

Do you have a system?

We continue to remind you about needing a *system*. What we are talking about is a system to operate your business at the local level.

Your business needs to be based on a set of refined and unified operating processes that you have tested and proven in actual operating locations and that your franchisees and their staff can execute independently.



REMEMBER

You are establishing the system and setting its standards. You are not going to be involved in the day-to-day management or operation of your franchisee's business. That is their job and responsibility. Making sure they can independently do that is essential. You must clearly define and document your processes and have the ability to do so in your manual library and training programs. You will need to

be able to train your franchisee and their management on how to continually train their own personnel (train-the-trainer) and you need to provide them with the necessary forms and checklists they need in order to be independent operators.

You can use these questions to gauge how well-defined your system is:

- » Can you deliver the “look” of the brand to franchisees? The design, décor, signage, site criteria, and plans for construction?
- » Are you able to tell franchisees approximately how much it costs to develop the location? This figure includes not just the fixed costs but the expenses from the day they meet you until the day they no longer have to fund working capital out of their own pockets. Remember, the franchisee is relying on you to be knowledgeable — especially in getting the business up and running.
- » Do you have systems for operating your business? As a franchisor, you want your locations to run consistently so that every customer is delivered the same product, the same way, every time. Are you able to document those procedures in operating manuals, and do those procedures work consistently?

Can you teach others how to operate your system?

Your franchisee generally won't know much about running your particular type of business, unless you're fortunate enough to have as your potential franchisees former management and staff of your current business. Therefore, you're going to need to train franchisees and their management team on how to run the business. Because it's going to be their responsibility to continually train their own personnel, you also need to teach them how to train.



REMEMBER

If your franchisees need to spend the next five years in class before they can open their doors and operate to your brand standards, you have a serious problem. To expand your franchise system, you need a system that can teach the franchisees the skills they need in a reasonable period of time.

Here are some questions you need to ask yourself:

- » Are the skills that your prospects need so specialized that finding enough prospects will be difficult?
- » Will your franchisees be able to hire enough help with the necessary skills?
- » Are you able to train franchisees to train their staff in your procedures, policies, and systems?
- » Can the training be completed satisfactorily in a reasonable period?

In order for your business to be franchisable, you need a pool of potential franchisees who are not only willing to invest in your franchise opportunity but who also will be able to operate their business to your brand standards. They also have to be able to recruit sufficient staff with the skill level to do the job.

Are your products and services any good?

Although having great products and services is no guarantee you will succeed, it certainly helps. Consider these questions:

- » Do you have repeat customers?
- » Are the reviews you receive on Yelp and other social media sites positive?
- » Do your reviews talk about why your products and services are superior to those of your competitors?
- » Are your product and service offerings broad enough to carry to the next town, the next state, or across the country, or are your products and services too localized?
- » Are the ingredients or raw materials the franchisee will need available in the markets you expect to expand into?

If you see new faces every day but wish some of the old ones would come back, you may have a problem. At some point, you will run out of new customers. Having a product that someone wants to come back to buy — hopefully, often — is the performance measure you have to meet.

As a franchisor, your product and services also have to meet the test of distance and of time. Even if you have the best products and services in town, do you know whether anyone outside your neighborhood will want them? To determine whether your concept has franchisability, opening up locations out of town might be necessary for some concepts. Also, bear in mind that the marketplace changes rapidly today. Products and services often have a half-life equivalent to that of a fruit fly in September. What is hot and essential today could be a faint memory tomorrow.

Here are some things you need to consider:

- » Are consumer-purchasing patterns changing, and will they affect the popularity of your product and services?
- » Can other companies absorb your product or service? If they do, will that place you at a competitive disadvantage? Do you have any competitive advantages or points of differentiation that no other company can offer?
- » Are competitors introducing, or even discussing, alternatives to your products or services?

- » Do you have a strategy to adapt to changing market conditions (culture, real estate, technology, consumer preferences, delivery systems, and regulations)?
- » How do you your customers view your price points? Can they afford to visit your locations frequently enough to make your business profitable?



REMEMBER

You need to be alert that your business is not simply the latest fad. Franchise systems need staying power and must be built on a consumer demand that is growing and secure.

Will the economics of the business support a franchise expansion strategy?

Likely, the most important factor for determining whether a business is franchisable is its ability to meet minimum economic requirements. You are going to expect your franchisees to pay you a fee to get into the business (called a *franchise fee*), continuing fees (called *royalties*), and maybe other fees, such as for additional training, marketing, and advertising.

Maybe you plan on earning income by selling products and services to your franchisees or possibly by collecting rebates from manufacturers or suppliers on system-wide purchases. Some franchisors lease equipment or property to franchisees in addition to having other a la carte fees. After those fees are deducted from the franchisee's bottom line:

- » Will they be profitable?
- » Will they be able to pay themselves a salary if they are managing the business themselves?
- » Can they service their debt?
- » Can they achieve an acceptable return on their investment?

Even if the answers to *all* of the questions above is yes, you still have to consider the following:

- » How many prospective franchisees can afford to invest in your franchise?
- » What will be their initial investment, including their working capital requirements?
- » How much of the initial investment will the franchisee need to pay in cash, and what portion will they be able to finance, and at what rate?
- » Do any regulations in your industry make it costly or difficult to franchise?

If your prospective franchisee is the operator of a single-unit, mom-and-pop business, she may be asking herself whether the franchise will give her a better income than the job she is thinking of leaving.

If your expected franchisee is a multi-unit operator or a sophisticated or institutional investor — and many franchisees are — they likely will want to know whether the franchise can generate a sufficient, predictable, and consistent return on their investment. They also will likely be comparing you to other investment opportunities, and some of those may not be franchises.

When you are looking at the total investment required by a franchisee, you need to factor in some other realities of your business:

- » Does your type of business have any serious short-term or seasonal cash-flow problems? If so, these problems could affect franchisees' total investment, depending on when they buy your franchise. These issues may also impact when you should start offering franchises.
- » Will franchisees need to carry a significant level of inventory?
- » How often will franchisees be able to turn over their inventory?
- » If food is involved, what's the rate of spoilage?
- » Will you need to set up any commissaries or central kitchens to support your expansion strategy? If you do, what is the investment required, and whose responsibility will that investment be?
- » How often will equipment need to be replaced or the business upgraded to keep pace with your industry and competitors?

You need to have a complete grasp of your economic assumptions and facts in order to determine what initial investment will be required by your franchisees and how well their businesses will likely perform.

Also, don't forget that the franchisee is not the only one in this relationship. To meet your own needs, you must know the answers to the following questions as they relate to your future franchise company:

- » How much will it cost to develop a franchise system for your company?
- » Can you afford to develop a quality system?
- » Will you be able to finance any shortfall in your development costs?
- » Will the fees you charge be enough to sustain you?
- » Will you be able to achieve a reasonable return on your investment?

- » If you are planning on using a broker to recruit franchisees, will there be enough left over after paying broker fees to meet your financial commitments and still obtain a good level of return?

Often, when you speak to some franchisors and ask the question “How’s business?” their answer will be something like, “Franchise sales are good — sold five franchises last month.” If the same question is asked of a larger or more experienced franchisor, the answer you will get will be very different. Great franchisors focus their attention on same-store sales (SSS) and other key performance indicators (KPIs). If you’re going to be a great franchisor, your head has to be in the bottom line of your franchisee’s underlying business — the franchisee’s unit economics drive all discussions.

If your economics are solid, and your concept is well designed and supported, marketing your franchise should not be very difficult. Indeed, one of the easiest things to do in franchising is market a franchise. The hard part is making sure that the franchise system is sustainable, that everyone is making a reasonable return on their investments (including you as the franchisor and each class of your franchisees), and that you’re selecting franchisees and not just selling franchises.

So what do you think? Are you ready to become a franchisor? Confirming feasibility is only the first step. You still have a lot more to do.



TIP

Although we have given you some of the basic criteria that MSA uses to evaluate a company’s readiness to franchise and that Gardere uses to guide their franchise clients, we have not given you the experience necessary to make a realistic judgment on your own. From experience, we know that people often have trouble objectively evaluating anything to do with themselves, and that is especially true when making self-evaluations of their businesses. Often the process can lead to emotionally charged discussions, and major issues are simply glossed over because they are difficult to deal with. It’s for that reason that a threshold analysis should generally be conducted by a third party. For additional information on conducting a threshold analysis, visit the MSA website at www.msaworldwide.com.

Beginning Your Franchise Program: Who Should Take the Reins?

Designing a franchise system requires time and a lot of expertise. In addition to the business issues that need to be addressed properly, legal work needs to be done to properly set up the franchisor entity, establish the legal relationships with third parties necessary to running your business, protect your trademarks and other

intellectual property (IP), learn the rules of the legal game you will be engaged in, prepare all the legal documents to implement the foregoing and comply with the law, such as your FDD. This is why taking advantage of guidance like that available through Gardere is an important weapon in your arsenal to lift off your business properly. Visit Gardere at www.gardere.com.

How you choose to proceed with the design and development of your franchise is important to your success as a business and as a franchisor.

Doing it yourself: Success or sure failure?

Occasionally we come across franchisors that have decided to save money on professional fees and develop the required legal documents themselves. They order a fill-in-the-blank set of franchise agreements and disclosure documents from an ad in the back of a magazine, download copies of existing franchisors' documents from the Internet, or purchase a few sets from one of the document-retrieval companies in franchising.

Their idea is that if those documents work for existing franchisors, why should they pay legal and consulting fees when they can use those same documents again for their system?



WARNING

Cutting and pasting another company's documents is a recipe for disaster — for all the business and legal reasons we have set out in this book.

The design, development, and implementation of any franchise system are complicated and require a significant amount of experience and expertise. Even if you decide to work with an experienced lawyer that doesn't routinely practice franchise law, in most instances copying from other people's documents is going to cause you significant problems for a number of reasons. For one thing, the documents you are copying from will be from established franchisors whose culture, resources, and objectives may be quite different from yours.

For another thing, every FDD has the same 22 items and a receipt page, but that doesn't make every set of franchise documents the same or even similar, even in the same industry. Although the flow of the documents may follow a similar legal structure, the information contained in those documents will be significantly different because they have been carefully crafted to meet the unique requirements, opportunities, and economics of that company and its franchise offering.



REMEMBER

Unless you've spent your professional life as a franchise executive (and not simply as a franchise salesperson), have established and/or managed multiple franchise systems before, understand the host of potential variations available for each critical area of a franchise system, and have a real-life understanding of what will

work and what will cause problems in specific situations, then you shouldn't do it on your own. Designing and developing a franchise program is not for the novice.

Franchise consultants frequently criticize law firms that create franchise disclosures and agreements solely based on extensive questionnaires completed by their clients. The reason consultants object to that process is because the client likely doesn't have sufficient background to understand the questions, and they generally don't have the background or experience to understand the myriad of options available to them in answering each question. Unless the proper professional rigor is employed in developing each business element in a franchise system, there is significant risk to franchisors when the franchise system is developed based on what is common or average in franchising or what other franchisors may or may not have done. This is why most successfully emerging franchisors were guided by both an experienced consultant and an experienced attorney.



WARNING

If the reason you want to develop your own franchise agreements is that you don't have the necessary resources and need to save money, you need to know that professional fees are the *least* expensive portion of developing and operating a franchise system. If you don't have enough money to hire qualified professional help, you should wait until you do. Going it alone may not result in immediate failure, but based on our experience it often leads to a slow and painful decline and the ultimate end of the business for what could have been a promising system, and causes significant problems for both the franchisor and franchisee down the road.

Watching out for “franchise packagers,” wolves in pros' clothing

We are going to spend a bit of time talking about franchise packagers because these companies provide little real value for the money they charge. If you choose to use a franchise packaging firm, the likely end result may be no different than going it alone (see the preceding section for more on how that usually goes). The quality of the documentation will not be much different, for example, because all the packager will be doing is cutting and pasting your information into the forms and agreements they have available.

Franchise packagers generally market their services to people who are inexperienced in franchising and who are looking for a simple way to achieve their dreams of becoming franchisors by buying complete packages of documents and services at one-stop shops. These companies masquerade as consultants, but instead of helping you evaluate, design, and develop your franchise system in a strategic and tactical manner, they sell you a package of boilerplate documents and services that they “customize” for you without actually doing so.

Franchise packaging firms prey on the “red meat” part of franchising — the inexperienced company looking to become a franchisor. You will frequently find them at the top of Internet search results in the sponsored advertising section. Because these firms generally have a hard time obtaining referrals from other professionals in franchising, they invest heavily in pay-per-click marketing and rely on potential clients *not* conducting proper due diligence on their capabilities before engaging them.

Legally, any lawyer can call themselves a *franchise lawyer*, and anyone can say they’re a *franchise consultant*. That’s unfortunate, because most professionals providing business and legal advice to companies in franchising are highly trained and experienced. Many qualified professionals in franchising have earned their Certified Franchise Executive (CFE) designation from the Franchise Education and Research Foundation (FERF), and some may also have additional licenses and professional designations, like a CPA, for example. Professionals in franchising follow the standards of practice required by the organizations providing them their certification.

Qualified franchise law firms like Gardere and experienced franchise consultants firms like MSA regularly work with both mature and emerging franchise systems and aren’t shy about redirecting a client away from those consultants and attorneys lacking in qualifications. We are often asked to repair or redo the work done by a packaging firm after a would-be franchisor has experienced difficulties with franchise regulators, is in litigation or in the middle of other problems with their franchisees, is unable to expand, is losing money, or is experiencing significant problems that could have been avoided.

In many cases, the problems these franchisors are facing are the result of poor advice and structural problems caused by the packaging firm having simply taken a boilerplate approach to how the franchise system was designed and developed. Many of the problems are also the result of legal issues that would not have occurred had they been addressed by a qualified franchise attorney at the outset of the franchise program’s development. We even find companies that should have never franchised, and the problems they are facing could have been avoided had they conducted a proper threshold analysis.

Some packagers highlight that their fees are kept low because they don’t waste your time on strategic planning and instead provide their “recommendations” in a few short PowerPoint presentations. Although it is illegal for consulting firms to do so, many packagers prepare the required legal documentation and have you bring it to a lawyer to review in an attempt to avoid the unauthorized practice of law. Others introduce you to attorneys they work with who can produce low-cost documents based on boilerplate disclosure documents and franchise agreements.

The packaging firms generally market a host of ancillary products and services that most emerging franchising should not be investing in initially, as an emerging

franchisor can anticipate significant changes once it has granted a few franchises and those franchisees have opened their businesses. These ancillary products, based on our experience, will have little use and value in a relatively short period of time because they will need to be redeveloped once the system has begun its initial expansion.

Still other packagers will reduce their fees or might not charge you *any* fee in exchange for equity in your franchise system or a percentage of your initial franchise fees or continuing royalties. Packaging firms that provide their services in this manner should always be avoided.

What surprises many new franchisors is that working with qualified franchise attorneys and consulting professionals not only provides them with a properly structured franchise system and proper legal documents, but the cost of those services is about the same or even less than they would pay the packager. The benefit of working with professional advisors is measured in the improved performance of your franchise system in the long term, which can be the difference between your franchise system succeeding and failing.

So, how can you identify a franchise-packaging firm if you are new to franchising? It's not hard. Follow these general guidelines:

- » Do an Internet search of their list of clients. See how many of their clients are still franchising today and how well the ones that are still around are doing.
- » Listen to their sales pitch. Do they recommend that you conduct a threshold analysis or do they brush it aside as not really being important in your case because your concept is so outstanding that you are destined to be a success?
- » Do they make you think that all franchise systems are the same? Do they claim that all you need to do is fill out their 60-page questionnaire, wait for them to prepare your legal documents, manuals, brochures, and video, and then sit back as dozens of franchisees line up to buy your exciting opportunity?
- » Do they provide you with a set of legal documents that their lawyers prepared for you and then require you to bring those documents to another lawyer for review and approval?

Consulting firms are not allowed to practice law even if they have a qualified franchise lawyer on their staff. Franchise packagers need you to get a lawyer to bless the documents they prepare for you because they need to avoid being sued for practicing law without a license. You are better served by engaging the services of a qualified franchise lawyer to prepare your legal documents rather than paying an additional \$5,000 to \$10,000 for some other lawyer to review the boilerplate forms and end up making significant changes anyway.



TIP

It is also important that you have qualified franchise lawyers prepare your documents. Many of the packaging firms work with lawyers whose firms prepare boilerplate agreements cheaply. In any situation, you should also ask for several recommendations, and before you engage any professional, make certain to conduct an independent due diligence on their qualifications and their malpractice litigation history.



REMEMBER

Your relationship with your lawyer is special as much of what you discuss with them is considered privileged and can't be disclosed. You will not receive the same relationship benefits, legal benefits, or quality work product from the packaging firm's lawyer.

- »» Do they simply want to sell you a basket of fill-in-the-blank legal documents? If you are that short on cash, you can get existing franchisor's documents for free online. Why would you want to pay for something you can get for nothing?
- »» Do they offer to develop your franchise system so that they can then sell your franchises for you? These packagers may be the scariest of all because they will take up to 50 percent of your franchise fee when they sell a franchise for you and usually another 10 to 20 percent of your royalty stream forever. When the franchise system has problems, and the franchisees fail to open, you are left holding the bag, but they still usually get to keep their sales commissions.
- »» Are the "consultants" that work for their firm independent contractors who may be working for them only while they are between jobs? Many franchise-packaging firms don't really have any staff. They engage out-of-work salespeople and other independent contractors while they are between jobs. A good indication of this is to ask the consultant to give you a business card and see if they even have the same card as the company you engaged.



REMEMBER

You need to address far more business issues than legal issues in developing a franchise system. The business determinations must define the content of the legal documents, not the other way around — and developing franchise documents solely based on a questionnaire generally is not a good practice.

Finding professional advisors to guide your way

You are going to need a team of qualified professional advisors to properly develop your franchise system, including the following:

- »» Franchise consultants
- »» Franchise attorneys

- » Accountants and auditors
- » Marketing professionals (advertising, public relations, social media)
- » Website and intranet designers
- » Franchise development professionals for your manual library, training programs, and franchisee recruitment program

In the beginning, your franchise consultant should act as the quarterback for the design and development team. After you launch your franchise system, your consultant should be available to help you manage and grow your franchise program.

You may already know of a franchise consultant, attorney, and others who are qualified to provide you with the support you will require. If you don't, here are some tips for finding the right professionals to work with:

- » For referrals, the firms with the best reputations are well known by franchisors and other professionals in franchising. Get referrals from people who know you and the type of business you are in, and who have received good results from the professionals they're referring.
- » Select consultants and franchise attorneys that are members of the IFA and the American Bar Association's Franchise Forum, who regularly attend their meetings, and who have been invited to speak and present papers to their franchise peers.
- » Meet with several consulting and law firms before you choose one. If the consulting or law firm is vague on what they provide or they speak only in technical terms, search for another firm that can answer your questions clearly. Have them prepare a detailed proposal for you and assess what their deliverables focus on.



WARNING

If the consultant is not spending most of their time and effort on developing the underlying franchise strategy and instead seems to focus on selling you ancillary products and services, look for another provider. If the attorney is moving you directly into preparing legal documents and is not first helping you to decide whether you are ready to franchise and recommending you work with a qualified consultant to populate the business terms of the agreement select another firm.

- » Make sure the law firm and consulting firm are familiar with businesses of your size and within your industry.
- » Choose experienced professionals with solid industry credentials and a reputation with large, established franchise systems and not just the small, emerging franchisors.

- »» Look for professionals that other professionals want to listen to and read. If the professionals you are speaking with are not regularly asked to speak at franchising programs and are not regularly published, move on.
- »» Be prepared to speak candidly about the firm's fee structure and what services they include. Make sure that you understand what you'll be getting.
- »» Talk to some of the firm's startup and more mature clients. See whether they're satisfied with the level of service they've received.
- »» Be comfortable that the professionals you choose are not only qualified but will communicate with you throughout the development process about the future of your business and how they can help you reach your goals.

It makes sense to first select your consulting firm because they will be developing your strategy and will understand your proposed franchise system the best. Every qualified franchise consultant will provide you guidance in you choosing a law firm and other professionals experienced in franchising.



TIP

One of the best sources for consultants, lawyers, PR firms, insurance agents, and pretty much everyone who services the franchise industry is the IFA's Supplier Forum (www.franchise.org/supplier-forum). Most knowledgeable legal and consulting firms are members of the Supplier Forum. (Co-authors Michael Seid and Joyce Mazero are past chairs of the IFA Supplier Forum and have served on the Board of the IFA.) In addition, Michael has been elected four times to the board of the IFA.



TIP

See if your consultants have obtained the CFE designation from the IFA's Franchise Education and Research Foundation. If they have, they're probably keeping abreast of the latest in franchise system structure and management.

You may have noticed that we never mention the need to select an advisor who is nearby. The right professional for you may be right around the corner or across the country. Franchise professionals really comprise a small community, and professionals are accustomed to working with clients wherever they are located. In the age of electronic communication, your distance from your advisor is really of little, if any, consequence.

Passing Go with Your Franchise Idea

Assume for the time being that your concept is franchisable. Congratulations! Do you hurry up and start to develop your legal documents and marketing brochures? Not yet. Hold off a bit more. You have a host of business issues to focus on and decisions to make before you bring in the legal and marketing troops.

Brainstorming a strategic plan

The business blueprint, often referred to as a *business plan* or *strategic plan*, examines the issues and makes the determinations needed to design and implement your franchising strategy. Although each company looking to franchise will differ, some of the key areas to consider in developing your franchise strategic plan generally include the following:

- » Accounting (control and reporting systems)
- » Capital requirements for the franchisor and franchisee
- » Communication with the franchisees
- » Consumer and other market research
- » Conversion strategy for independent operators
- » Cooperatives and buying groups
- » Core and tertiary market expansion strategy, including determination of the various classes of franchisees to use for expansion
- » Development and implementation of the internal structural elements of the franchise system
- » Franchise relationship strategies, including dispute resolution and dispute prevention
- » Franchisor field services
- » Financial planning and analysis
- » Franchisee operations
- » Franchisee recruitment, selection, and closure
- » Franchisee staffing, training, and certification
- » Franchisor organization and training requirements
- » Insurance requirements
- » International expansion and support
- » Investment hurdles to determine fees and other system revenue and costs
- » Legal documentation, including FDD and franchise and other agreements
- » Location (selection, acquisition, development, and management)
- » Management information systems and point-of-sale systems
- » Marketing (advertising, publicity, and promotion)
- » Merchandising standards and plan-o-grams

- »» Monitoring mechanisms for product and service quality and consistency
- »» Ongoing services provided to franchisees and a la carte fees, if any
- »» Packaging and labeling for products sold to consumers by franchisees
- »» Policy formation
- »» Warranty and guarantee programs

The franchise system you ultimately develop and the franchisor–franchisee relationship you establish will be shaped by the determinations you make in designing the franchise system. You decide upon planning, policies, procedures, ongoing administrative monitoring, and support services in the strategic and tactical plan.



PLAY THIS

You can check out an expanded list of elements that you need to evaluate in the design and development of your franchise program at this book's companion site. Go to www.dummies.com/go/franchisemanagementfd.

Fleshing out your strategies

After you develop your tactical and strategic plan, you also need to begin to develop some of the components required for executing your strategy. These include the following:

- »» All the operating systems and procedures
- »» Operations manuals for each class of franchisee, management, and staff
- »» Operating manuals for the franchisor's headquarters and field and other support personnel
- »» Training programs required for all the system participants
- »» Marketing programs for use by local operators to attract and retain retail and system customers
- »» Marketing programs to recruit franchisees, including discovery days, websites, brochures, trade shows, and so on
- »» The fee structure for the franchise system
- »» Required documentation (developed by qualified franchise attorneys)

Creating a plan for action

Finally, you should create an *action plan*, which will organize and schedule the tasks you need to complete in implementing your franchise development plan.

Your plan should provide for controls and feedback to ensure a clear direction for the company, an understanding of who is responsible for what, and the timeline for making everything happen. Control over the timing of your plan's implementation is critical. The action plan ensures that something is going to happen and describes when to do it.

One reason that many franchise packaging firms skip the process of developing a strategic plan and instead substitute a lengthy questionnaire is that strategic planning is time consuming and can raise issues that you need to address to properly design, implement, grow, and support your franchise system. It also allows franchise-packaging firms to artificially keep their fees low but puts you at risk.

Developing the legal documents

The final output of your initial strategic development is the preparation of the legal documentation for your franchise system. You should base all the terms contained in your legal documents on the decisions you made during your strategic planning process. Your franchise agreements convey the information that legally binds you and your franchisee, spelling out the relationship between you and all your franchisees and describing the system. The FDD and franchise agreement provide prospective franchisees with at least the minimum information required by law and professional practices. The franchise agreement incorporates the business terms contained in your FDD that spell out each party's obligations to the other.



TIP

To give you a better understanding of structure of the FDD, we have included an online analysis of the structure of the FDD at this book's companion site. Check out www.dummies.com/go/franchisemanagementfd. In preparing the FDD and franchise agreements, reliance solely on a FDD questionnaire is not advisable, as we have noted. However, if used as a tool to expand discussion, a questionnaire can be helpful. You will find a sample FDD questionnaire on the companion site.

In addition to the documents we've provided as online tools, we recommend that you also prepare and use with your consultant and franchise attorney a strategy document. MSA's proprietary document is called a *business overlay*, which is an enhanced version of a strategic and tactical plan that explains all the key issues to your attorney so that they can prepare the franchise agreements, franchise offering circular, and other required legal documents. It also provides guidance to the rest of the development team in areas concerning real estate, manuals, training, retail marketing, franchisee marketing, IT, and so on. In addition to its clarity, a business overlay saves the lawyers developing the franchise document a considerable amount of time because the issues the attorneys need to address are covered in detail.

After you complete your plan, you and your consultant should meet with your attorneys and other advisors and present them with your strategic plan. Seek their input and advice, because they have experience that should prove beneficial to your franchise system. Remember, though, that franchising is a business strategy, and your legal agreements need to reflect the decisions you made in your plan. If the language in your agreements doesn't reflect the thinking of management and your business plan, speak to your attorneys before the documents are completed. Although customs and practices exist in franchising, and some elements are routinely found in many franchise systems, none of those matter if they don't work for your franchise.



TIP

One last bit of advice: Take your time and don't get caught up in entrepreneurial fever ("I must get it done now!"). Most of us who work in franchising as franchisors, franchisees, consultants, and lawyers learn something new every day about business and franchising. Professionals seize every opportunity to attend professional forums where we can exchange ideas with other professionals about best practices and worst practices in franchising. Take the advice we give you, thoroughly review all the chapters in this book, and seek out professionals who can help you through the process. When franchising is done well, there's no better method of business expansion.

- » Sifting through potential franchisees
- » Selecting the right markets
- » Recruiting franchisees
- » Giving franchise sales presentations

Chapter **15**

Recruiting Franchisees

Recruiting franchisees and closing the deal is easy. It really is. All you need is a solid message, a great franchise marketing team, an exciting concept with a queue of people lined up to buy your products and services, a support system hyper-focused on each franchisee's bottom line, the willingness to listen, and a prospective franchisee. But being able to recruit franchisees and close the deal isn't enough to be a great franchisor.

To be a *great* franchisor, you need to build a network of great franchisees. That requires you to be selective and often patient. Great franchisees will have confidence in your concept, understand and believe in the culture of your franchise system, support your leadership, and consistently deliver on your brand promise. Even with all those qualities, one more piece is still needed: the knowledge, skills, abilities, and financial capabilities required to independently *recruit* and *manage* their own great team of employees.

By now, hopefully, you have some sense of what is required to be a great franchisor. This chapter talks about the hard part — understanding the methods for recruiting great franchisees.

The Essence of the Ideal Franchisee

The words we use in describing things are important because our words paint a picture. In franchising, maybe because it's easy, maybe because the franchise

community has become lazy, or possibly because other terms are less understandable or simply too nuanced, you will hear people talk about franchisors “selling” franchises, and franchisees “buying” franchises. However, what is really being offered is a limited license to use another party’s intellectual property for a defined period of time. Franchises cannot really be sold or bought. Franchises are licenses and therefore are awarded and accepted. The only thing a franchisee owns will be the assets they purchase in establishing and operating their businesses.



REMEMBER

Franchisees don’t really *own* a franchise — they are licensees of another person or entity’s intellectual property. But for convenience’s sake, we also sometimes talk about franchise sales and salespersons.

Maybe because it makes the relationship feel warm and fuzzy, the franchisor-franchisee relationship is sometimes called a *family* or, worse, a *partnership*, with the franchisee referred to as a *partner* or possibly a *franchisee partner*. Unlike a partnership, though, the franchise relationship is not a fiduciary relationship. If you think your franchisee is your partner, see if your franchise attorney will be willing to put that into your franchise agreement — trust us, none will. We have never understood why some folks in franchising seem to need to use the term *partner* at all, as the franchise relationship is a truly beneficial one and doesn’t need to rely on any other term.

Franchising is also often referred to as an *industry*. And because it has its own trade association and a body of law and culture surrounding it, we can see why. But franchising itself is not an industry. It is merely an alternative method of expansion or distribution used by many diverse industries.

In the same vein, franchisees are frequently referred to as *entrepreneurs*. An entrepreneur, according to the Merriam-Webster dictionary, is “one who organizes, manages and assumes the risks of a business or enterprise.” Although that definition includes most of the attributes of a franchisee, franchisees are not the *organizers* of the business concept they license and operate, nor do they have any right to independently change it. The difference between an entrepreneur and a franchisee is that an entrepreneur doesn’t have to follow anyone else’s direction except their own. So, what is the problem with an entrepreneur as a franchisee? After all they have so many of the attributes we want in a franchisee: energy, drive, and ambition.



WARNING

The problem with a true entrepreneur is that they want — need — to tinker. A true entrepreneur has a clear focus on what they want to create and are not satisfied until they make changes to their business to make it fit their own image. As a franchisor, if you let that happen, franchisees will do their own thing, and your system will never achieve the necessary consistency.

What you are really looking for is a “formula entrepreneur.” Someone who has most of the attributes of an entrepreneur but is willing to follow your lead and

understands that consistency throughout the network of locations is essential. Franchisees need to know that they are obligated to meet your brand standards and execute your strategy flawlessly, but still possess the burning desire to own, operate, and manage their own business. Those are the great franchisees you want to recruit into your great franchise system.

Recruiting great franchisees take patience and the willingness to say no to someone who is unqualified to be your franchisee but is willing to write you a check. Turning down a check is difficult — you will need to overcome this difficulty because not everyone who wants to become your franchisee will fit.



REMEMBER

Take your time and be disciplined in your approach to recruitment and selection. In the long run, a bad franchisee diverts you from doing productive work and hogs the attention and resources you need to support the rest of your franchisees. The money they pay you will never be enough to make the wrong franchisees worth the effort.

Focusing Your Market Strategy

Growth should be strategic. If you are going to succeed, you need to determine where and when you should open in new markets. You need to determine which markets will be your primary targets, which will be your secondary markets, and which you are unable to grow in because you won't be able to affordably provide support to your franchisees.

Expanding without a plan is potentially dangerous because supporting distant, isolated locations is expensive and will absorb precious human and financial resources in your early days. If you stretch yourself too thin, your entire system may suffer for lack of attention to quality standards.

When MSA develops an expansion plan for its emerging franchise clients, we factor in a host of considerations. We begin by understanding the initial and continuing support requirements of franchisees and then determine the franchisor's financial and human capabilities. Although we explore the company's contractual obligations to franchisees, which must be met, what is essential is that the company's initial franchisees are successful.

The goal for a franchisor must be for its franchisees to succeed. This is especially true for a franchisor's initial franchisees. Keep in mind that your initial franchisees make their investment decision substantially based on trust in their future profitability and your capabilities to support them. Future franchisees will have an advantage in that they will be able to talk to those franchisees about how well their businesses are doing and your capabilities and level of support.



TIP

Validation by existing franchisees to prospective franchisees will be the most important element of determining how well you will be able to grow and expand in the future.

In addition, we examine the company's capabilities in these areas:

- » Financial ability to market for franchisees
- » Supply chain management
- » Performance of company and franchisee-owned locations
- » Efficient enforcement of brand standards
- » Franchisor's goals, culture and exit strategy
- » Franchisor's existing internal assets — both human and systemic — available to support franchisees

An unfocused market development strategy (one in which the markets selected for development are determined by where the prospective franchisees' phone calls or emails come from) will cause the company to be reactive rather than proactive, at all levels. For example, without a market expansion plan, you may fail to register your franchise in markets where you should be targeting or may incur unnecessary expenses by registering and advertising in states where you should not be expanding yet.

Your expansion decisions need to be based on measurable criteria. What expansion methods you target for expansion — single-unit or multi-unit franchisees or even further company-owned development, in addition to the critical mass requirements in different types of markets — should be understood. Understanding the distance customers will travel to your franchisee's location and the population (people or businesses) needed to support each franchisee's business are needed to decide on how many locations are required to achieve critical mass for your brand. Understanding critical mass requirements, among other things, enables a franchisor to better manage its field service and distribution costs per unit and provides the most effective way to capitalize on local marketing possibilities.

The goal isn't merely to enter new markets, but also to enter them successfully. Distinguish your core market opportunities (in major and secondary urban areas) from tertiary market opportunities (in all other areas) so that you can profitably support your franchisees through effective field support, advertising, and other necessities that will be critical to your success as a franchisor. Knowing your critical-mass requirements enables you to better plan your growth.



TIP

Having company-owned locations spread out over a host of markets can drain a company's resources. If you have company-owned operations that are spread out and causing you strain, you should evaluate whether you should sell those businesses to franchisees. You can then take the proceeds from the sale of those stores to growing company-owned units elsewhere, paying down some of your debt or marketing and supporting new franchises. Following this approach is part of what is called a *refranchising* or *retrofranchising* approach. See Chapter 12 for additional information on these concepts.

Reeling In Great Franchisees

Not every person who wants to be your franchisee will be the right candidate for your franchise system. This is true even if they have been successful in some other franchise system.

Defining the franchisee profile

Too often, franchisors let candidates join the system simply because they have the necessary money. That is called a *fogging the mirror* strategy. If the prospective franchisee is breathing — and can therefore fog a mirror — and has enough money in their checkbook, welcome aboard. It's an easy mistake for a young franchisor to make because turning down any franchisee (and their money) is difficult.



TIP

No prospective franchisee will ever be perfect, and looking for the perfect franchisee will cost you opportunities. Have balance in your approach to selecting franchisees. Understand where the prospective franchisee's weaknesses are and determine whether you can realistically provide the needed training and support to overcome them. If you can, you might have a winner. But if not, and you still select that franchisee, it could be one of the costlier mistakes you will make.

Even though no franchisee will ever be perfect, we can begin with trying to understand what the “perfect” franchisee might look like for your franchise system. To accomplish that, you need to define the traits that perfect franchisees will require. Consider looking for the following traits:

- » Ability and discipline to successfully and independently manage and operate their business to your brand standards.
- » Willingness to follow your system without any alteration to how you want your products and services delivered to customers.

- » Financial resources. It isn't enough for them to have the capital to open their location — they will also need the funds to get them through the unexpected hard times that often will follow.
- » Track record for success. Do they have a proven background and the necessary skills in creating success in other ventures? Do they have a stable and successful employment history?
- » Ability to absorb new lessons. You are going to need to teach the prospective franchisees about running your concept, but can they absorb your approach and are they willing to follow your direction?
- » Enthusiasm about your concept as it exists. Do they have a burning desire to change your business because of what competitors are doing or because they think their market is different?
- » Ability to operate independently. Can they independently manage and supervise their staff to accomplish these critical requirements?
- » Self-motivation. They should also be willing to take the necessary risks necessary for success.
- » History of litigation. When confronted with problems, is their solution to work through the problem or do they immediately reach for a lawsuit?
- » Willingness to live in the market where their business will be located.
- » Ability to manage and delegate responsibilities. If they will be multi-unit franchisees, delegation is going to be important because they will be operating more than one location and cannot be in more than one place at the same time.

You need to understand, before you close the deal, whether the franchisee will fit well with your concept, organization, and other franchisees. What you are looking for are franchisees that will be able to:

- » Relate to your customer bases.
- » Relate to the types of employees they will need.
- » Be able to create the proper environment to motivate their employees.
- » Fit into the distinct culture you are trying to exhibit at each level of the franchise system.

It's also important that your franchise opportunity meets the income expectations or requirements of your potential franchisees. You can observe prospective franchisees' lifestyles and should have an understanding of their income history from their application. Choosing a franchisee who likely will be disappointed in the results of the business isn't a wise choice.



TIP

The franchisee profile you develop serves as a set of guidelines. It allows you to know in advance the profile of franchise candidates you want. Knowing the right profile will impact your marketing for franchisees and how you conduct your recruitment process. Making sure you're targeting the right pool of prospects is important — the future of your company hinges on it.

Doing it yourself or through third-parties

At MSA, we prefer our clients to internalize their franchise recruitment efforts. Although third-party services like brokers can be useful for new franchises, because they can add an additional level of validation for the system, those services may not be available for an emerging franchisor, and for most franchisors they are unnecessary and may not even be beneficial.



WARNING

In Chapter 14 we discuss the risk of using franchise-packaging firms. We explain that some franchise packagers also try to act as your broker in exchange for a percentage of your continuing royalty. Without question, these service providers should be avoided.

Franchise packagers that offer to sell franchises for you frequently offer lower fees or even charge nothing for the development of your franchise system in exchange for taking a percentage of your franchise fee, your continuing royalty, and even some equity in your franchise system. Their income comes from commissions they make on selling franchises for you.

Your focus as a new franchisor should be on developing a franchise system that is sustainable because you selected the right franchisees and have the necessary revenue to support your obligations to them. The problem with franchise brokers is that their goals won't necessarily align with yours. Their goal is to earn a portion of your initial and continuing fees — therefore, sustainability of your franchise system is not necessarily a high priority in how they advise you in the development of your franchise system. To be a successful broker/packager requires them to sell franchises quickly rather than strategically or intelligently. Their goal is to award as many franchises as they can, rather than award franchises to only the right candidates, and that often means the initial and continuing fees and the obligations for the franchisor and franchisee are established for that goal alone, and their selection criteria for selling franchisees may not be aligned with the selection requirements necessary for sustainability.

Consider also that even if the franchise broker doesn't ask for equity, they will often ask up to 50 percent of your franchise fee and frequently a minimum fee that that is even higher. They will also often require between 10 percent or more of your continuing royalty. Run the numbers. After paying the franchise broker a portion of your initial and continuing fees, what will be left for you to sustain your

franchise system and earn a reasonable return on your investment? Also your contractual responsibilities will continue, whereas the broker's will end once the franchise agreement has been signed. Working with a broker has the potential for serious conflicts of interest and long-term financial problems, and it is a relationship that emerging franchisors should avoid.



TIP

For most franchisors, internalizing their franchise recruitment process is preferable and with proper training and support, new franchisors can effectively do so. Professional consulting firms can provide their clients and their staff with the tools required without giving up equity or revenue. For example, at MSA we use an incubator approach for our emerging franchise clients that trains our client's staff, or if needed, helps recruit personnel, to execute their unique selling program.

Reaching out through the right media

Once the profile of your franchisees is in hand, you need to determine their media habits as a group. This helps you reach your profiled candidates and facilitates your obtaining great franchisees for your great franchise system. Pay attention to the following characteristics:

- » **Geographic:** Local, regional and national
- » **Demographics:** Age, income, gender, and family size
- » **Psychographics:** Values, interests, attitudes, personality, and lifestyle



TIP

If your franchise system lends itself to alternative distribution possibilities like operations in stadiums, arenas, airports, hospitals, universities, and other mass-gathering locations, you should consider the culture and management style of those concession firms in profiling potential franchisees.

Marketing for franchisees

As you begin the process of marketing your franchise system, you will quickly find that following up on leads takes up a lot of human and financial resources. If you are using the right media mix, you should be generating a productive lead flow.



REMEMBER

Be careful how you assess the results — the goal isn't to get as many leads as possible; it's to close the maximum number of great franchise prospects and do so at the lowest cost possible. Shotgun advertising indiscriminately may generate a lot of franchise leads but may not generate the type of franchisees you want and need. That is one of the basic problems many franchisors have with the abundance of leads coming from the Internet. Although getting leads over the Internet is great, and paying Google an additional fee for directing those searches to your site is

often worth the investment, remember that many of your leads may actually be coming from 12-year-olds with a mouse.

Your franchise marketing material should contain a filter in the message that focuses it on the person or group of investors you want. By doing so, it also helps those who are not your candidates to self-select out of the process. One common technique is a minimum net-worth requirement or a minimum cash-investment requirement.

Having an application on your recruitment website for the candidate to complete when they initially contact you is fine. If you have a unique franchise offering, keep your initial application focused and short. You will have plenty of time during the recruitment process to have the candidate provide you with all the information you require.

In establishing your marketing plan, consider these five basic questions:

- » Who are your candidates? Clearly understand their profile.
- » What are the appropriate sources for generating leads for recruiting franchisees that best fit the franchisee profile you have established?
- » What methods (financial, personal, and so on) will you use for evaluating potential franchisees?
- » What procedures are you putting in place for approving franchisees?
- » What administrative procedures and negotiating strategies do you need to have in place to close the sale — and do it legally?

To be successful in marketing your franchise, you need to address these basic issues before you start spending money on marketing — not after.

Franchisors use a wide variety of marketing and advertising vehicles. They select a mix of media that they believe will effectively reach their targeted prospects and achieve a reasonable cost per prospect lead, and ultimately an effective cost per franchise sold. Some of the options include the following:

- » **Your website:** Your franchise recruitment website has most of the information your prospect will be looking for. Make sure it's working for you, is robust, and has the information your prospect is looking for. It won't by itself make the sale, but it should ensure that your prospects have sufficient information to keep them engaged and interested enough to take the next step of contacting you.
- » **Mobile device optimization:** Make sure you have a unique franchise recruitment website that is also optimized for mobile devices, because that is how many of your prospects will first read about your franchise offering.

Make sure it links directly to your main franchise information site and always give the prospect the ability to easily call you from their mobile device, if that is their preferred method of communication.

- » **Search engine optimization (SEO):** The Internet is king, and making certain that Google and the other search engines have you featured on the paid listings, and more importantly on the organic listings, requires you to understand search engine optimization. Paid search and your willingness to make the required investment are essential. But equally as important — and just maybe more important — is to ensure your website and blogs are visible to search engines by including the proper keywords your prospect will be searching for. When it comes to your franchise recruitment website and your mobile device site, optimization is key. The requirements change almost daily, so work with a professional firm that understands how to maximize franchise recruitment sites.
- » **Behavioral retargeting:** Have you ever visited a website to purchase something and then, even if you don't buy anything, that company's ads seem to stalk you on every site you visit thereafter? You have been *behaviorally retargeted* (also called *retargeting* or *remarketing*). It's a method used by advertisers to follow you across the Internet. Basically, retargeting is a cookie (a file) that is placed on a website visitor's computer, and each time they travel to various websites, your advertisement will be there waiting for them. Retargeting is relatively inexpensive because it only markets to people that have already expressed an interest in you.
- » **Social media platforms:** LinkedIn and Facebook are well-known social media sites that have morphed into terrific franchisee-recruitment sites because they both offer targeted marketing opportunities. In addition to enabling you to maximize your retargeting efforts, these sites allow you to target markets based on the profile of your targeted franchisee.
- » **Lead-generation sites:** Lead-generation sites or portals can be important because they make a significant investment in pay-per-click and rank highly on organic search. They will provide valuable information to prospects looking at your franchise as well as information on your competitors. They also provide links to your franchise recruitment site.
- » **International Franchise Association:** The IFA is the most important franchise trade association in the world (www.franchise.org). It's also the first website many prospective franchisees visit to learn about franchising and to connect with franchisors and suppliers. On the IFA's website is a list with extensive information, publications with advertising opportunities, and links to its franchisor members (www.franchise.org/franchise-opportunities). The IFA also publishes the *Franchise Opportunities Guide*, a compendium of its members and an advertising resource for franchisors.
- » **World Franchise Council:** The WFC is an association of over 40 national franchise associations (www.worldfranchisecouncil.net). Many, like the

IFA, have information about their franchisor members, their publications with advertising opportunities, and links to their franchisor member's websites.

- » **Franchise trade shows:** The annual International Franchise Exposition (IFE) draws thousands of visitors in search of franchise opportunities. The three main shows each year are Franchise Expo South (January), the International Franchise Expo (June), and Franchise Expo West (November). Contact the exposition's producer, MFV Expositions (www.mfvexpo.com) for dates and locations.
- » **Franchise Update Media:** Franchise Update Media (<http://franchiseupdatemedia.com/category/conferences>) publishes some of the most influential publications in franchising. It also holds important conferences. Its Multi-Unit Franchise Conference targets the growing segment of multi-unit franchise operators and is held in Las Vegas in the spring.
- » **Franchise Times:** *Franchise Times* (www.franchisetimes.com) is a leading news, research, and information source. It conducts several yearly conferences for professionals in franchising. Many franchisors use *Franchise Times* for advertising, and it is a solid lead-generation publication.
- » **SiriusXM:** For franchisors, national radio has generally been cost prohibitive, despite its reach. SiriusXM (www.siriusxm.com/advertise) has opened opportunities with programing that includes sports, politics, music, and lifestyle programing that can target prospective franchisees.

Franchisors use a host of additional sources of lead generation, including

- » Print media, such as national, regional, local, and weekly newspapers, business journals, trade newspapers, and magazines
- » Newsletters, blogs, and targeted emails
- » Franchisee referrals
- » Franchise opportunity information exhibited in existing locations
- » Targeted mailings to potential franchisees, including strategic and institutional franchisees that meet the franchisor's criteria
- » Trade missions
- » Franchise sales brokers

You may notice that we did *not* include public relations (PR) in the preceding list of lead generators. PR by itself doesn't generally generate any franchise leads.

PR, however, is an essential tool used by franchisors to drive prospects to all the other lead-generation sites and in the process highlights content that gives readers third-party validation of the franchisor's message. PR generally provides more depth to the reader than an advertisement and can be effective in introducing new concepts to audiences where the concept is unknown.



REMEMBER

Today there are a plethora of franchisee lead-generation options available to franchisors, allowing for targeting of specific audiences. Each media vehicle is unique in the audience it is targeting and how it delivers a marketing message. Although one media source may be right for one type of messaging or one targeted prospective franchisee, it may be a waste of resources in targeting another. Having a recruitment plan and an understanding of the profile of your franchisees will make for a more effective use of your budget.

Measuring effectiveness

In choosing the media you will be using, it is a mistake to rely on a “survey of one” or even of a few. Although your franchise recruitment staff may be the best in closing the deal, that doesn't make them marketing experts, and unless they are, get the help of franchise marketing and media professionals who do this for a living.

As we discuss later, it is also essential that you frequently measure which lead-generation sources are most productive for you. Understanding your cost of closed deals by source is more productive than measuring your cost of leads. Having a lot of leads is great — if they turn into franchisees. But if a high percentage of those leads don't convert into closed sales, all you're doing is burning up a lot of human and financial costs in processing leads from non-productive lead-generation sources.

Measuring the closing percentage of franchise prospects that complete your applications is also important. That metric will give you a good guide in understanding the effectiveness of your franchise recruitment personnel.



REMEMBER

You likely will have more than one franchise profile and more than one offering if you're targeting single-unit and multi-unit franchisees. And your multi-unit franchisee profiles may be different, based on the classes of multi-unit franchisees you're looking to recruit. One message for all prospects won't be productive any more than one type of lead-generation site. The lead-generation site and your messaging must be appropriate for the classes you're trying to recruit.



TIP

Franchise Update Media's Annual Franchise Development Report (www.franchising.com/franchisors/afdr.html) benchmarks trends in franchise recruitment for the past year. Also, talk with other franchisors about what is working for them.



TIP

Use a contact management system (CMS) to track your source and cost of leads and closed sales from multiple sources. Although CRMs can be costly and may be tedious to use, the cost and effort will often pay for themselves in additional sales and avoiding lost opportunities.

Don't wait to make a sale before measuring the effectiveness of your marketing dollars. Gather reports weekly to track the effectiveness of each site at the critical steps of the process, highlighting the following information for each lead generation method:

- » Number of leads
- » Number of closed deals
- » Cost per lead
- » Cost per closed deal
- » Average time to close deals
- » Average time on your website
- » Number of applications received
- » Percentage of closed deals after application
- » Number of disclosure documents sent to prospects
- » Percentage of closed deals after disclosure
- » Number of prospects coming to Discovery Days
- » Percentage of closed deals after Discover Days

In addition to tracking metrics for each lead-generation source, make sure you also track the performance of the members of your recruitment staff. Just because they are handling a lot of leads and seem productive, if they're not consistently turning those leads into deals, they're not being effective.



TIP

Although most of your prospects will likely contact you electronically, many will simply pick up the phone and call. Regardless of how they contact you, getting back to them quickly is essential. Think of how impatient you get when you send someone an email and they don't respond to you within a few minutes. While your prospective franchisee is waiting for your response, they are likely continuing to explore other franchisors on the Internet. Make certain you have an auto-responder built into your website. If you have the budget, having an initial video presentation on your franchise opportunity and your recruitment process can also be useful.



TIP

Also maximize the time your franchise recruitment staff has with prospects so they don't spend their time processing through the initial leads. It is useful to have as part of your recruitment team an administrator who can respond each morning to every lead that comes in, do an initial processing of them, and, for those leads that are potential prospects, set up appointments for your recruitment staff to speak with them.

ATTRACTING VETERANS THROUGH VETFRAN

There is no fighting force in the world as powerful and respected as that of the United States. We admit we are biased toward our nation's veterans, and co-author Michael Seid had the honor of serving in the U.S. Army. Many veterans today make up the leadership in franchising as franchisors, franchisees, and suppliers. What makes our peace-makers so brilliant at the job is their training: They understand a mission, execute it brilliantly, and always exceed expectations under consistent pressure. Those are precisely the same attributes found in great franchisees and franchisors.

To say thank you to our veterans and their spouses, following the first Gulf War and under the leadership of the late Don Dwyer, Sr., a board member of the IFA and founder of the Dwyer Group (Waco, Texas), the IFA established its VetFran program in 1991. After 9/11, Dina Dwyer, then a future chairman of the IFA and chairman of the Dwyer Group, re-launched VetFran. (The Dwyer Group brand of companies includes Aire Serv, Five Star Painting, Glass Doctor, the Grounds Guys, Mr. Appliance, Mr. Electric, Mr. Handyman, Mr. Rooter, Molly Maid, Portland Glass, Protect Painters, Rainbow International, Locatec, and Window Genie). Don and his daughter Dina believed that it was essential to support our servicemen and women as they returned to civilian life by providing them with expanded opportunities in franchising. According to Dina Dwyer, "Don Dwyer believed that one of the best ways to say thank you to our veterans was to provide them a chance to live the American Dream of business ownership through franchising." We agree.

VetFran (www.vetfran.com) is an IFA member-supported initiative to provide preferential access to franchise opportunities. Each VetFran member company has developed its own veterans' offering that may include a reduction in fees and additional support in financial assistance, training, and mentoring. The IFA's VetFran Committee has also developed a VetFran Toolkit (www.vetfran.com/vetfran-toolkit) to provide veterans and their families with additional assistance and education. Since it was re-established, VetFran has grown to a network of over 650 franchised brands, more than 6,500 veteran-owned franchise business owners, and close to 250,000 veterans and their spouses as either employees or franchisees.

Developing the Recruitment Organization

There is a difference between marketing a franchise and selling a product or service. In franchising you are offering an intangible — the use of a franchisor’s intellectual property (its brand and system) in a business that is independently owned and managed by franchisees. It’s a long-term relationship that is being offered based on trust.

Successful franchise recruitment is a learned art, and for a good professional franchise salesperson it isn’t hard to close a deal. Although economic performance is critical to sustaining every franchise system, the investment decision for prospective franchisees is in many ways an emotional one.

Great franchise salespeople are successful because they can convey to the prospective franchisee information about the franchise system and let the prospective franchisee feel the passion they have for the brand. They also tailor the recruitment process to ensure that the prospective franchisee builds a bond with the brand. When that emotional bond between prospective franchisees and the brand is created, and a sense of trust between the system and prospective franchisees is established, prospective franchisees start to both see and feel themselves in your business. At that point the deal is done. Sounds easy — and it is for an experienced franchise recruiter.

Once prospective franchisees have a basic understanding of your concept from reviewing your information on the Internet, they will generally contact you to learn more. At this point prospects are still shopping and comparing franchise opportunities and are far from the point where they are ready to make a commitment to any brand. They also are likely looking not just at your direct “retail” competitors but also at competitors for your franchise in several other industries.

To maximize the value of your leads, your response speed is essential. In your off hours, an auto-responder with a well-scripted message is essential. During business hours, a live reply will go a long way. For leads that are received during your off hours, there is nothing more important than sending out a live message in the first few hours of the next business day, if not sooner.



REMEMBER

The prospective franchisee will be continuing to shop. The quicker you interrupt that process by engaging the prospect in an active dialogue about your franchise offering, the more you will improve your ability to maximize closure on the leads you receive. Put yourself in the prospects’ shoes. They have questions, and for many, this will be the first time they are thinking about investing in a franchise. Some will be nervous even talking to you. The franchise recruiter needs to educate them on the opportunity and put them at ease with your recruitment process.

In many franchise systems, the prospect will have a preliminary conversation or exchange with a screener or administrative assistant. The purpose of that conversation or email exchange is to gather some basic information and relieve the franchise salesperson from taking the time to talk to people who likely are not real candidates for your franchise opportunity.



TIP

Make certain that if you have this role in place, the screener is trained and good at their job. After all, they are the first person interacting with the prospect, and first impressions are often the most lasting. Also, you don't want to lose a good lead because the screener did not understand or was too quick to cut the prospect off.

Gaining the trust of prospects and easing any concerns each may have is the first step. Advance the dialogue by answering some of their basic questions, discuss the recruitment process, and give the prospect a sense of what it would be like to operate the business and what steps in the recruitment process come next. This is the responsibility of the franchise salesperson after the prospect has had their preliminary contact with the screener. It is essential that the prospect also begins to understand that you are looking at the discussion as leading to a long-term relationship and not simply a sale.

So, who should you have conducting your franchise-recruitment process? For emerging franchisors, that role is often performed by the founders, simply because there may be no one else. Who better to convey passion for the brand and an understanding of the franchise offering and system? Many franchise systems begin and continue for a long while with the founders as their chief recruiters. One concern is whether the roles of salesperson and operations executives are aligned. The salesperson role is short term in focus, and the operations executives have a longer-term focus with responsibilities that include supporting the franchisor's franchisee and enforcing brand standards. These roles should not conflict, but in the real world, they can.



TIP

Many franchisors recruit a franchise salesperson — an experienced “hired gun” — or engage the services of a franchise broker. Experience in franchise recruiting can be of significant benefit, but at MSA we generally recommend to our clients that they look internally first for individuals who understand how your brand functions at the retail level. There is nothing as powerful during the recruitment process for a potential franchisee to know that the person answering questions is doing so out of practical experience and isn't simply regurgitating scripted information. Prospects that are new to franchising and those that may be multi-unit operators in other systems will want to understand things about how your business functions, including how you schedule your staff at the unit level, order inventory, market for customers, open in the morning, and close at night. When a prospect can hear war stories from someone who has actually done it successfully, it can be powerful.

What your internal person is lacking is the knowledge of how to successfully recruit and close the deal. Using the right internal person — a staff person who has managed some of your locations — to train that person on how to market your franchise offering successfully, is preferable. Franchise recruiting is a learnable skill, and we teach and support our clients in this area all the time.

If there is no one on your staff with the basic skills needed to even be trained, and you decide to bring on board an experienced franchise recruiter, the first job is not to begin marketing your franchises. The first job is to go to work in one of your locations in every department and learn what you do for a living. Let them learn enough to be credible about your business and give them enough time to have their own “war stories” based on their experience.

Have one person in your organization who can shepherd a franchise candidate through the franchise selection process. Doing so allows you to:

- » Establish trust and rapport with each prospect.
- » Prevent viable candidates from slipping through the cracks.
- » Give prospects the attention they need, allowing for a more thorough fact-finding and interview process.
- » Customize the selling process to each candidate's buying style.
- » Avoid a situation where a prospect plays one person in your organization against another.

Contact management software

As we noted earlier, we recommend using a contact management system to track discussions with prospective franchisees. Many franchisors have developed their own software or have turned to third-party software developed specifically for franchising, including the following:

- » FranConnect (www.franconnect.com)
- » FRM Solutions (www.frmsolutions.com)
- » Naranga (www.naranga.com)
- » IFX Franchise Management Platform (www.ifxonline.com)

Being disciplined allows you to track a franchise candidate's progress through the recruitment process, maximizes your recruitment investment, captures important dates and commitments, monitors the sales process, and records the essence of each contact a member of your staff has had with each candidate.

Finding the right franchise recruiting professional

The one thing that's rarely in short supply is people who claim to be great salespeople. The one thing that is always in short supply, however, is people who actually are great salespeople. If you're going to recruit a salesperson from outside your organization, here are a few tips for sources to consider:

- » **An executive search firm specializing in franchising:** There are several really good search firms supporting franchising. You can find a partial list by looking at members of the IFA's Supplier Forum (<http://franchise.org/search-by-supplier>). Two firms with long histories in finding franchise talent are Capodice & Associates (www.capodice.com) and Franchise Search (<http://franchise-search.com>).
- » **Your franchise lawyer and consultant:** Besides often knowing personally the best professional franchise salespeople and who might be available at any time, your franchise lawyers and consultants have access to a powerful information source: their professional network. Ask them.
- » **Other franchisors:** Franchising may be a major part of the economy, but it's a relatively small network of companies. It's also a community that shares information. Calling other franchisors about candidates they might have interviewed but did not select for various reasons can be a very good source of information on who is looking for a new position.

Although executive search firms can add significant value — because they have interviewed and conducted background checks on candidates they are representing — it comes at a cost. The professional network in franchising is very strong, and although we use executive search firms all the time, we generally begin looking for any candidate by networking with others in franchising, because they general know the best people for the job, and of course we can avoid the cost of the executive search firm.

Staffing your recruitment organization

There are four basic functions that you will need to staff:

- » The screener or administrative assistant
- » The franchise development staff
- » The compliance officer
- » The approval committee

The screener or administrative assistant

The screener, or administrative assistant, is responsible for the following:

- » Responding initially to all sales leads that come into the system
- » Conducting the initial screening with the candidate
- » Receiving and verifying completeness of the basic information received — applications and so on
- » Coordinating appointments for the franchise-development team
- » Completing all scheduled mailings in sequence and on time
- » Scheduling the candidates for meetings, including Discovery Days
- » Coordinating all the resources necessary for Discovery Days
- » Maintaining the prospect's file and ensuring that all information, including the receipt for the FDD, is on file
- » Ensuring that the franchise agreement is complete and that a copy of the final and completed contract is in the prospect's hands for the legally required time period
- » Staying in touch and understanding the deal flow coming from the brokers working with the franchise system
- » Ensuring that the development team has the necessary information for their discussions with the candidate
- » Taking care of a zillion other little tasks so that the development team can focus on the recruitment process and not on administrative details

The franchise development staff

The franchise development staff is tasked with the following responsibilities:

- » Field all prospective franchise inquires
- » Hold telephone and direct meetings with prospects
- » Build trust with each candidate
- » Set the franchise recruitment agenda
- » Determine the hurdles each candidate needs to achieve to be qualified
- » Prequalify each candidate
- » Decide when to pass on any candidate
- » Shepherd each qualified prospect through the recruitment and approval process
- » Close the sale

The compliance officer

The compliance officer is essential for keeping the franchisor on the right side of franchise sales laws and regulations and ensuring that the process goes according to system standards. They are not a member of the recruitment team and should not report to anyone involved in the franchise recruitment process.

It is the responsibility of the franchise development team to manage the recruitment process and close deals. The franchise development team is usually compensated with a bonus or commission tied to the sale. The role of the compliance officer is to avoid costly mistakes.

Usually, the compliance officer is a member of the accounting or legal staff. This person needs to be detail oriented and willing and able to take a stand when they identify issues in the recruitment process. You can also include an outside professional, such as your franchise attorney or a member of their staff, to fill this role. The compliance officer needs to be well trained in franchise regulatory compliance and serve as the franchise system watchdog to ensure that everything during the recruitment process is handled according to the law and your franchise selection process. Their most important responsibility is to stop a contract from being signed if they are not satisfied that the company has followed all the necessary procedures and fully completed all the required paperwork.

The role of the compliance officer is important, and their determinations should be taken seriously and rarely overruled.

The approval committee

The franchise development team is responsible for franchise recruitment and closure. The compliance officer is responsible for ensuring that the recruitment process follows the regulatory requirements and the policies of the company. The role of the approval committee is to make certain that each franchise candidate meets the franchisor's entrance requirements and will be a good fit for the system before signing the franchise agreement.

The approval committee is generally made up of executives and department heads responsible for supporting the prospect after they become a franchisee. The members of the approval committee generally include the following:

- » Executive management
- » Marketing
- » Operations
- » Real estate
- » Merchandising

- »» Training
- »» Legal
- »» Supply chain
- »» Accounting and finance

You may notice that no one from the franchise development team is a member of the approval committee. This is to avoid any conflict of interest between the salesperson's role (whose compensation is frequently dependent on the making of the sale) and the role of the committee to look at the prospect from the long-term view and decide whether they should be allowed to join the franchise system. The salesperson has already registered his or her vote by advancing the candidate to the approval committee.



TIP

In emerging franchise systems, where qualified personnel are limited, the members of the franchise development team will likely play some role on the approval committee. However, as the franchise company grows, the bifurcation of roles described here should become a priority.

Optimally, each member of the approval committee should have met personally with the prospect and should be ready to discuss their perception of the candidate. It is important that members of the approval committee from all levels of the company — not just the executive level — have a chance to interact personally with a candidate. Often a candidate will act differently when they are interacting with someone lower than with the “top brass,” and how that candidate interacts with this level of personnel often illuminates that candidate's true character. During the meeting the approval committee should review each applicant's file and that of the compliance officer and make its approval decision. The members of the approval committee should not be compensated directly by the franchise recruitment process, because this will better ensure that members' votes are not tainted by any economic benefit they might get from approving any candidate.



TIP

Throughout any Discovery Day, everyone is on their best behavior. Still, Discovery Day can be very tense for many candidates who have never been through the process before. One trick of the trade that is very effective is driving the candidate back to the airport or their hotel after Discovery Day rather than having them drive themselves or taking Uber. It is remarkable, once the pressure of the day is gone, how open some franchise candidates can be in their comments about the franchisor's team and possibly even how they think they will need to change the concept or advertising to fit their “unique” markets. Obtaining that level of understanding of a prospective franchisee can be very important in your decision about whether the franchisee can fit into your system and its culture.



TIP

After the approval committee has discussed each candidate, there will be a vote. Other than recording the results of the vote, it is advisable to refrain from making any written record of the discussion or keeping a detailed log of the vote. And, unless the prospective franchisee can cure the reasons for any rejection (a lack of financial resources, for example), there is no reason to justify or explain why the candidate did not meet the requirements of the committee. Giving a reason will almost always cause bad feelings and potentially other problems. If a member of the approval committee believes that a candidate is still not a good fit, even if it's just a gut feeling, you should discuss those concerns. Frequently, even if a candidate meets each of your selection criteria, there may be other issues of concern. Also, there is no perfect candidate.

Ten Steps to Franchise Recruitment

A comprehensive recruitment process ensures that you consistently process every franchise lead you receive. Creating the most effective process for each company can be complex and takes time.

Everyone involved in franchise recruitment needs to be trained in the franchise law and regulations applicable to franchise sales. This includes your receptionist and any unit managers at locations you intend to bring potential franchisees to during your Discovery Days.

A one-size-fits-all recruitment process isn't possible. What works for one company may not work for another. For example, when MSA works with clients in the design and development of their recruitment process, we understand that for some brands, having a Discovery Day at the beginning of the process will be appropriate, but for others it should happen in the middle or at the end of the process. Although we can give you broad recommendations, the procedures you use need to be the right ones for you, but may vary for each class of prospective franchisee.

Whatever recruitment process you decide upon, it should be detailed and made available in writing to your recruitment team so they understand their roles. When circulating your written plan, ask for comments from the team to ensure you have captured different franchise sales scenarios that your team may encounter. Following a process hopefully will allow the process to flow well, ensure you have the best opportunity to close deals, and also help prevent your approving the wrong candidate for your system.

Your recruitment and selection process should do the following:

- » Build trust and give candidates the information they need
- » Ensure candidates understand that you are committed to brand standards

- » Provide you with the opportunity to highlight your strengths, including but not limited to headquarters and field support
- » Inform the candidate that you are selecting franchisees, not selling franchises, and that means you are looking for the best candidates
- » Gather the necessary information to move the prospect through the recruitment process
- » Keep you in regular contact with each candidate sufficient for you to
 - Obtain a better picture of whether the candidate fits into your system.
 - Allow you to build a long-term relationship.
 - Allow the candidates to become excited about your system as an investment opportunity for the long term.
 - Enable the prospect to conduct a proper due diligence on you.

During your recruitment process, you should include hurdles that the prospect must meet, including setting dates for them to meet those hurdles. Doing so accomplishes a few basic things: It lets them know you are serious about selecting franchisees and not in selling franchises, and it lets you assess the candidates' ability to follow a system and to meet their commitments. In addition, by doing so you set the right tone for the relationship after they become franchisees.

Each time you communicate with any prospect, you have the opportunity to answer questions, provide new information, and clear up any misconceptions. Although ultimately you want to drive candidates to a decision point that allows them to open up a new location, you also need to learn whether the prospective franchisee is right for your system.

The following sections cover the ten steps generally included in a recruitment process. When you design your own process, you may have more or fewer steps, or you may put them in a different order. Over time you will develop the appropriate process that works for your brand.

Steps 1–4: The introductory phase

Regardless of the source for your franchise lead, initially you need to get the ball rolling, and that starts with prequalifying the candidate:

1. Prequalify, or screen, the prospect.

You need to communicate with every prospect as soon as possible. With how people use electronic communications today, even a few hours' delay can mean a lost opportunity.

Emails are fine for acknowledging a prospect and for providing basic information. Although talking on the phone may seem old school, nothing gets the relationship started better than direct person-to-person verbal discussions. Set up a convenient time and call them.

Your initial conversation should be scripted, enable you to gain basic information on the prospects, preliminarily assess whether they are a suitable candidate, and answer their basic questions. If you included a preliminary application on your website, now is the time to probe any obvious issues, but it isn't the time to dig deeper — that will come later.

2. Provide the candidate with your initial information.

Your prospects already have a lot of information about your company and your franchise opportunity from their preliminary research, including what you have on your recruitment website. Following your preliminary call with them, email them any information package you have prepared. If it contains any application or forms they need to complete to go to the next step, establish a time frame for them to complete that process and get the information back to you. Also set up a time for someone on the development team to call them or to set up a meeting.

If the prospect did not meet your criteria, there is no reason to email to them your information package or to continue the discussion. There is no reason to encourage candidates with whom you likely won't continue the process with anyway.

3. Set up the applicant's file.

Establish a file in your contact management software that allows you to maintain all records and communications in one place. Each contact and a brief discussion of each call or contact you have with the prospect going forward should be recorded in this file. Should the candidate become a franchisee, you will want to have on hand a complete record throughout the time as a franchisee of your system.

4. Do an initial follow-up call and set a date for the candidate to visit your headquarters for Discovery Day, if you will be having Discovery Day at the beginning of the process.

Contact the prospect and discuss again with them any of the information they sent to you. Answer their questions and continue to move them through the process. If necessary, find out why the candidate has not returned any promised information on time. (See the "Working the Validation Process" section, later in this chapter.) Use this opportunity to continue to build rapport.

In most situations the process won't go as smoothly as those four steps imply, and may require multiple discussions to move the prospect to a Discovery Day meeting. That's fine as long as you feel positive with the process.



TIP

One reason some franchisors put Discovery Day early in the process is to avoid spending a lot of time with candidates who might not fit. Also, when Discovery Day is scheduled earlier in the process it can create enthusiasm in the prospects, prompting them to complete their due diligence and move forward faster. Having them come to Discovery Day early will do that. Still, many franchisors hold their Discovery Day later in the process.

Step 5: Discovery Day

Discovery Day is a structured day of meetings at your headquarters, where you interview the prospects, provide them with information on the system and the franchise opportunity, give them a tour of your headquarters and usually a few locations, and answer their questions. The candidates will be meeting with your team, and most franchisors will use the opportunity to have the prospects make some form of presentation to them. Your overall goal is to create excitement, make the prospects feel like they're already part of your brand, and assess each candidate's potential as a franchisee.

If you did not send the prospect a copy of your FDD before they came to Discovery Day, make sure you provide one now. If you sent it in advance, verify that you received back a signed receipt page — and if not, get one while they are in your office.



PLAY THIS

Many franchisors today provide electronic disclosure of their FDDs to prospective franchisees. We include an overview of e-disclosure on this book's companion site at www.dummies.com/go/franchisemanagementfd.

If you had sent the prospect an FDD in advance, you should have scheduled time on the phone, making use of a webinar if possible to walk the prospect through the document. It is a large document and can be very intimidating to new franchisees. If you didn't send them one in advance, make sure you thoroughly review the FDD with them now. Whether through a webinar or in person, you should have a scripted presentation that anticipates any concerns they might have, highlights the positive features of the franchise agreement, and puts anything that may appear negative in a more positive light.

If the potential franchisee will have multiple owners, or if the prospect has a spouse or partner that will be part of the franchise relationship, make sure that all of them come to Discovery Day.

Step 6: Follow up after Discovery Day

If the approval committee has decided to reject the candidate after meeting with them at Discovery Day, notify them as soon as possible and do it tactfully. You want to maintain their good feelings about the company, and, as mentioned

earlier, unless they can fix the reasons for their rejection, going into a discussion of the reasons really won't be fruitful.

If the candidate wants to move forward and meets your standards for approval, let them know they have been tentatively approved. Tell them that your approval committee will be meeting to review the information it has received. Let the prospect know what additional steps they will need to complete. Continue the process by making sure the candidate follows up on any tasks you gave them during Discovery Day, such as contacting existing franchisees, looking for locations in their market, or having discussions with their lenders. During this period you can also follow up on the candidate's credentials, if you haven't completed a background check, now is the time.

Step 7: Follow up again

Stay in touch with the candidate. There is a 14-day period after you give the candidate your FDD before they can sign a franchise or other binding agreement under the Federal Trade Commission (FTC) Rule. However, the 14-day period isn't meant to be a quiet period.

Let the candidate know what's going on in the process and keep them engaged by answering their questions and following up with them on the tasks you agreed they would be completing. Let them know about events in the system so that you continue to make them feel like they are already part of the system. If you have a conference or event going on, consider inviting them to it. Also, try to get them to agree upon a date for making a decision and for signing the franchise agreement.

Step 8: Make a decision

Decision time! Get a commitment that the candidate wants to become a franchisee and agrees on a date to sign the franchise agreement.

Step 9: Close the deal

Now you get to seal the deal. Convey to the prospect the decision of the approval committee. Make sure you deal with any objections or jitters the prospect may have, to smooth the transition. Ensure that all paperwork and requirements have been met and received. Make sure that all the terms of the franchise agreement are complete.

If you make changes to the franchise agreement that was provided in the FDD or include information in the final agreement that your prospect has not had a chance to review, you need to provide them with the final franchise agreement at least seven calendar days before signing.

Verify with the compliance officer that any open items have been completed, that the 14-day and 7-day periods have been met, and that they approve the transaction going forward. Also, though you've likely received final approval by the approval committee, if you haven't, now is the time to do that.

Step 10: Complete the process

Congratulations! You have a new franchisee.

If at all possible and convenient, have the prospect come in to sign the franchise agreement. Making it a memorable event. Lunch, a gift, and some recognition and excitement are the appropriate ways to begin a long and hopefully positive relationship. Don't forget to get that check or an electronic payment when the franchise agreement is signed.

Whether the candidate comes in to your office or the signing takes place remotely, you should immediately begin the startup process with your new franchisees. Getting them going as soon as possible on parts of your training, like site selection, will help to alleviate any potential "buyer's remorse" that the franchisee may suffer. Most new franchisees, after signing the franchise agreement, will question whether they made the right decision. Show them what a good decision they made by immediately providing them with support.

On this book's companion site we include a sample franchise sales and compliance manual (not customized for your franchise, so you will need to customize it and have it reviewed by your franchise attorney) to help you meet the rules that govern the offering of a franchise. Go to www.dummies.com/go/franchise-managementfd.

Working the Validation Process

Your franchisees should prove to you that they can keep their commitments to the system after they become a franchisee. At the same time, you are trying to convince them that your system is the right opportunity for them. The best way to accomplish that is to give prospects assignments and dates they need to meet to get it to you. Hold them to those dates. Some of the tasks you can give them during the process include the following:

- » Completing the preliminary and more in-depth application on time
- » Returning the FDD receipt page

- » Meeting with their legal, financial, and other advisors
- » Applying for financing from their bank
- » Looking for locations
- » Researching the demographics of their desired markets, as well as any state or local laws and regulations that may impact their business
- » Visiting some of your locations
- » Coming to Discovery Day
- » Talking to your current and former franchisees

In Item 20 of your FDD is a list of your current franchisees and those who have left the system along with their contact information. Have your prospects contact your current and past franchisees so that they can get comfortable with your franchise system and begin to understand what being a franchisee is all about. This process allows them to ask about your capabilities as a franchisor and also to get answers from franchisees about the financial performance of individual operations that you may not be able to answer.



TIP

Although you should not steer your recruits to your most favored franchisees or those who like you the best, you can assist them by matching them up with franchisees in similar markets or to franchisees who share similar profiles. Who the prospects call is their choice, and you should let them know that. Have them give you a list of which franchisees they are likely to call so you can alert those franchisees to expect a call. This will facilitate your current franchisees in giving the prospect information about the system, but refrain from telling the franchisee what to say or what not to say.



TIP

Make sure you call each franchisee that the prospect has called so you can get feedback on the prospect. You also want to hear the types of questions the prospect is asking, which will give you a good indication of how serious they are about your opportunity and what their doubts or concerns may be.

Follow up with prospects on the calls they're making to ensure they're getting the information they need. Address any issues or concerns that may have surfaced during their due diligence. The recruiting process is a two-way street, and making sure your prospective franchisees are comfortable with your system is as important as you being comfortable with them.

When a potential franchisee checks in with your existing franchisees, you can also get incredibly important feedback on your performance as a franchisor. What will your current franchisees tell a prospect about you? We hope you've lived up to the promises you made to your franchisees so that you get the positive validation

necessary to convince prospective franchisees that your system is right for them. If not, make it a priority for you to do better.



WARNING

Some franchisors will pay a commission or provide some form of monetary reward to franchisees that participate in the recruitment process. Take care if you choose to do so and discuss this carefully with your consultant and attorney. Paying money or providing other material rewards to your franchisees could technically turn them into a broker or sales agent.

Many franchisors use a validation service that independently contacts your franchisees and scores your system. Some of the companies that provide these validation services can be found at <http://franchise.org/search-by-supplier>.

The Franchise Sales Presentation

The major differences between a franchise sale and any other type of sale are the legal time limitations in franchise sales and the types and format of information you may present or are required to present.

Unless you or your prospective franchisee is exempt from disclosure, you must deliver your FDD at least 14 calendar days before you sign the franchise agreement or accept any payment. Generally, the prospective franchisee must also receive a franchise agreement containing all material terms at least seven calendar days prior to the signing of the franchise agreement if you make any unilateral changes to the form of the franchise agreement provided in the FDD or included information in the final agreement that the prospect has not had a chance to review.

You can use the 14-day period to your advantage. When a prospect has your FDD, let them know that for the next two weeks you want them to learn more about your franchise program, and you want to learn more about them. Explain that a franchise agreement is a two-way street. It requires a continuing commitment by both parties. Furthermore, it isn't an automatic process. Encourage the franchisee to seek outside legal and business advice.

During the 14-day period, you may discuss the franchise agreement with prospects and their advisors and continue to advance the recruitment process. The 14-day period isn't a "quiet period." Some franchisors also allow or require their prospective franchisees to work for a period of time in a location so that they can get a better understanding of the business.

On occasion, prospective franchisees will try to turn the selling process on you by stressing their strength and importance as a candidate. They may try to negotiate terms of the franchise relationship. Talk to your franchise consultant and your

attorney to understand what potential areas of your agreement might be possible areas for negotiations. Some potential areas might include the franchisee's protected or exclusive territory or additional training and support the prospective franchisee may want.

If the prospective franchisee is requesting changes in areas that you won't change, explain that you have a selection and approval process and that your franchise agreement is designed to protect the franchise system, including the other franchisees. Explain that when the prospect becomes a franchisee, the selection process and the terms in the franchise agreement will benefit them as well.

Discipline in recruiting franchisees is an important aspect of establishing a professional relationship with your prospect and with all future franchisees. Present the franchise program to the prospect completely. Review with the franchisee the system and the terms of the agreement. Review the history of the franchisor. This process enables you to share your strengths with and build a compelling case for seeking admission into the franchise.

You want to build the prospect's excitement in joining the system. Discuss an overview of the industry and why your opportunity is unique and beneficial. Discuss the franchise agreement and the system, such as the following:

- » Operational support provided
- » Field visits
- » National account programs
- » Technology advances of your company
- » Buying groups
- » Information technology
- » Training
- » Advertising and marketing
- » Other services provided by the system
- » Other factors unique to your offering

Be prepared to discuss, knowledgeably, the offering of your direct competitors. Smart prospects have already obtained information on other franchisors and may even have copies of their FDDs. Having a working knowledge of your competitor's FDDs allows you to address comments and concerns on why they should choose your system over any other.

You should be prepared to discuss the system's fee structure, including the initial franchise fee, continuing royalty, local advertising requirements, brand fund contribution and any a la carte fees. Don't try to justify your fees and tie them to the services you provide. Your fees are being charged as an admission cost for getting into the system and using your brand, as well as to pay for the franchisee's continuing membership.

In reality, unless your lawyer has tied your fees to services in the contract, which would not be advisable, the services you are providing to your franchisee are simply those services you think they need to independently manage and operate your brand to your standards. Also make sure the prospective franchisee understands franchisees' obligations to your system. Take these one at a time and get commitment to fulfill each obligation:

- » Initial investment (Item 7 in the FDD)
- » The requirements to meet standards of your franchise system
- » Territorial rights
- » Market penetration strategy
- » Term and renewal of the agreement
- » Termination of the agreement
- » Training
- » Transfer and all the other key provisions

Be prepared to let the prospective franchisee review the operations manual and training program outline. Go over each section of the manual if they want to review, but don't let them make copies. Have them and anyone else who will be looking at the manual and training program sign a confidentiality agreement prior to reviewing them. Explain why you selected each procedure in the manual and how it benefits the operation of the franchise and the system.

Be prepared for the question "How much can I make if I buy your franchise?" Your answer will depend on whether you have included a financial performance presentation in your FDD about the financial performance of franchisee- and company-owned units. Consult with your franchise attorney and consultant on how they want you to answer those questions. See Chapter 4 about Item 19 and financial performance representations.

Just to be clear, a financial performance representation is basically any statement that claims, suggests, or provides a specific level or range of past or projected sales, income, or profit. Talk to your franchise consultant and your franchise attorney about unit operating cost information that you can provide to prospective

franchisees without including a financial performance representation in Item 19 of the FDD.

If you make a financial performance representation, you must disclose it in the FDD and must also have a reasonable basis that you can substantiate if asked to do so by the prospective franchisee. The FDD must also include the factual basis for your claims and any assumptions on which you based them.

What types of earnings questions should you expect to hear from your prospects? The following kinds of questions are typical:

- »» What gross sales should I expect from my store next year?
- »» What percentage of labor costs have you experienced at your company-operated units?
- »» I understand that I can purchase my paper products through your supplier. What do you think will be the percentage of sales for my paper costs over the course of 12 months?
- »» I know that you just opened a few restaurants in Washington, DC. Do you know what sales for the unit on M Street are?



REMEMBER

Consult with your franchise attorney and consultant about how to answer these important questions from the prospect. Make sure you answer all the franchisee's questions, clearly and honestly. Tell prospects the truth. They will be in your franchise system for many years. Recommend to your prospects that they discuss questions regarding financial performance with the existing franchisees in the system. This is a good idea even if you provide a financial performance representation in Item 19 of your FDD.

Finalizing the Selection Process

After the prospect has indicated that they want to become a franchisee, your approval committee should review the application. Explain to the franchisee that this is part of your best-practices approach to the franchise system.

At the final interview, explore any unanswered questions (both yours and the prospect's) and make sure you are both satisfied that the decision is the right one for both of you. At the conclusion of the meeting, assuming that it has been 14 days since you gave the candidate your FDD and that the seven-day period for holding the completed franchise agreement has elapsed, you can execute the franchise agreement and related documents and accept your franchise fee! Just to be safe, check with your compliance officer or your franchise attorney. After all, they are your safeguards to proper franchise sales practices.

- » Understanding the franchise international expansion rules of the road
- » Investing in internationalizing your franchise
- » Connecting with non-U.S. franchisors and non-U.S. prospective franchisees

Chapter **16**

Expanding Abroad: International Franchising

It's certainly exciting to envision taking your franchise overseas, and that's what we talk about in this chapter, but first you need to remember that all the advice and guidelines we've offered in this book still apply should you choose to explore this option. It is also important to understand — and we mean understand at a very deep level — that if you're not ready, if your domestic franchise system is not working well, if you don't have the necessary resources, then going international is not going to solve any of your problems. Indeed, going international when you're not ready can make things at home much worse.

Planning for international expansion is essential. Imagine throwing darts at a map and deciding to locate your franchises wherever the darts land. Easy, yes. Smart? No. An unfocused expansion strategy is financially dangerous — to your brand and to your existing franchisees. It wastes marketing resources, makes maintaining quality standards difficult, makes supporting the system cost-prohibitive, often leaves your franchisees in a poor competitive position in their markets, and ultimately can lead to franchisee unrest — or worse.



REMEMBER

If you want to have a reasonable chance of being successful internationally, the only way to franchise your concept is through planned and controlled growth. You have to select markets that strategically make sense for your brand and the products and services you offer. This involves *market planning*: determining which markets are your primary targets, which are your secondary or tertiary targets, and which are not targets at all. Remember, wherever you go, and whatever type of franchising you use, you need to support your franchisees, even when they're overseas.

Criteria for choosing markets typically include determining which type of products or services will sell and are appropriate in your locations, identifying the demographics of the markets, assessing the competition, figuring out your supply chain and logistics, understanding local economic issues, getting advised on the local laws impacting your ability to protect your brand, understanding how you will receive payment, enforcing your franchisor rights, and increasing revenue.

Taking Your Franchise Abroad: Know What You're Getting Into

Success as a franchisor in the U.S. doesn't guarantee success abroad. Unfortunately, war stories abound about franchisors drawn to the allure of "going international" by prospective international franchisees who, in contacting the franchisor about a franchise opportunity in their country, have flattered the franchisor into thinking it is ready to franchise internationally. But in reality, the franchisor has not even skated on the surface of the planning that it takes to effectively and successfully export the brand internationally. Many franchisors succeed internationally, and you hear about them. Many don't succeed, some go back to the drawing board, and some fail — those are not as frequently reported on.



WARNING

Falling prey to flattery from prospective international franchisees or believing in an opportunity that is "too good to be true" has caused many a U.S. franchisor to lose substantial amounts of money and has harmed their brand in both their domestic and foreign markets — making it difficult for these franchisors to find qualified franchisees and expand in the future. Unfortunately, many franchisors have entirely pulled out of some foreign markets or ended up reselling the franchise rights to a second or even third franchisee in certain markets, because mistakes made early on in the expansion process made a healthy lift-off internationally almost impossible. Once harmed, the franchise brand becomes further damaged by the churning of franchisee leadership in those markets. With each churn of leadership, the level of leadership and commitment to the brand in the market exhibited by prospective international franchisees diminishes while the franchisees' goal of getting the franchise rights on the "cheap" increases.

It's not always necessary to experience something to know it's not a good idea. But failing internationally has caused many franchisors to rethink their approach. They go back to their original vision and develop an international expansion strategy that better aligns with their readiness, both financially and operationally, to expand outside the U.S. These franchisors had to absorb the losses caused by not dedicating the appropriate capital, resources, and personnel, misjudging the foreign market, and in many cases, just picking the wrong franchisee — or worse, picking the franchisee for the wrong reasons. This is something you want to avoid and with proper guidance you can.



REMEMBER

In order to successfully take on the challenges of international franchising, at a minimum you need to have a stable and profitable domestic business. You need a business organization that can leverage its resources to support your international franchisees, who will be the face of the brand in the local markets.

Selecting the right franchisees is as essential internationally as it is domestically, and making the right choice takes just as much dedication and time. Just as with your domestic franchisees, selection requires planning and an objective investigation into who the prospective franchisees are and whether they can be successful.

Supporting international franchisees requires having dedicated and talented people and systems in the U.S. and on the ground in the local market in order to provide your franchisees with the services that they will need. Thinking that you can fly a field consultant over to occasionally provide support to an international franchisee is a recipe for failure.

You will also need to consider how to sufficiently internationalize your products and services to meet the demands of new markets. You not only have to make sure you have a supply chain sufficient to provide your franchisees with the products and services they need, but those requirements, including those applicable to compliance with local law, will differ from market to market.

Kay Ainsley, managing director of MSA Worldwide, is recognized as one of the leading authorities on international franchising because of her experience as a franchisor, with MSA's clients, and from her international leadership within the International Franchise Association. Kay provides this thought: "I have seen too many franchisors expand internationally too early or before they were prepared and have watched them fail unnecessarily. You don't begin to offer franchises overseas simply because you receive a call from someone in Dubai or some broker has convinced you that you can make some quick cash. You franchise internationally only when you are ready and only after you have developed a well-thought-through and validated plan that you can adapt based on each country's unique requirements."

When you begin to give serious thought to international franchising, here are some of the points that you should consider:



TIP

- » **Your products and services:** What changes to your products and services, if any, will you need to make so that customers in the foreign market want to buy your products and services? What is the availability and cost of qualified local labor? What kind of spending power or discretionary income do local consumers have? Is your supply chain adequate to ensure that you international franchisees' needs are met?

Consider cultural and local market tastes in making your move overseas. For example, in India, cows are observed as sacred within the Hindu culture. You probably won't offer a beef-based menu in this local market, where a great deal of the population does not eat beef and would be offended if you offered it.

Although modifications for the local market will be needed, be careful about making significant changes to your system too willingly or too quickly. Your products and services have been successful based on your current consumer offering and system. With the world growing smaller and smaller, consumers in foreign markets often want an authentic American offering. Some franchisors will remind you that modifying their products and services for the local market too early was a mistake as the consumer was looking for that authentic American experience. Other franchisors regret not making sufficient accommodations for local tastes and customs.

- » **Local economic issues:** You need to examine a market's trade barriers or other local risks (such as government approvals and restrictions, corruption, government instability, high unemployment, excessive employee benefits, rampant inflation, and high tax rates).

You could use published market intelligence reports to distinguish which markets are easiest and most difficult for you to enter. For example, use resources like Transparency International (www.transparency.org), a nonpartisan database that indexes political and corporate corruption activity throughout the world. You can also use information in The World Factbook published by the Central Intelligence Agency (www.cia.gov/library/publications/resources/the-world-factbook).

Will the franchised business be impacted by restrictive U.S. or local laws? For example, the U.S. Department of the Treasury has an Office of Foreign Assets Control (OFAC), which administers and enforces economic and trade sanctions. OFAC maintains a list of countries and specific individuals that may restrict with whom, in what country, or for which types of products and services a U.S. person can transact business. Addressing these types of issues before considering overseas operations will help you avoid a high-risk, yet low reward, market scenario.

- » **Supply chain and logistics:** Are you able to identify and use local suppliers? If not, and you have to ship goods to your international franchisees from the U.S., what unique supply chain costs will you incur? For instance, how expensive is shipping? Will you encounter issues related to transporting perishables? Are there any special labeling or packing requirements? Will you run into import and export issues inside the market you are shipping to? How long will it take to get the products there? Will you or the local franchisee need to establish logistics arrangements for warehousing and transportation? Be sure to flag these issues and analyze whether there are better ways to solve the supply chain challenges and who will pay for these supply chain costs, as they can add up quickly.
- » **Internal buy-in:** Do you have buy-in from your management team? Have you shared your plans with your domestic franchisees? Do you have the internal personnel and resources to locate, conduct investigation on, interview, travel to meet, and obtain references on potential international franchisees? Will there be an orientation and onboarding program for new franchisees in place? What part of your recruiting and support program can be outsourced to a third party and what part do you need to do yourself? Consider how undertaking an international expansion plan could impact your brand culture internally and with your domestic franchisees. For example, if you become less attentive to your domestic franchisees in enforcing system standards or executing innovative marketing programs, you risk weakening the very base that positioned you for international franchising. Avoid giving your domestic franchisees the perception that you have forgotten about them.
- » **Deal structure:** Have you decided on the deal structure that best suits expansion of your business? There are numerous models of international expansion, including, for example, master franchising, direct franchising, multi-unit development franchising, and joint ventures. Each has pros and cons primarily related to the amount of control the franchisor has over enforcement of system standards and the ability to terminate the franchised business and continue to expand with other franchisees, just to name a few. For example, if you plan to use direct franchising, you can retain more control over expansion and you won't have to share royalties with an intermediary. However, with more control in direct franchising, you may experience slower growth rates, have greater servicing costs and collect fewer short-term fees. See Chapter 2 for a more specific description of each of these arrangements.
- » **Translation issues:** What do you know about the local language and dialects typical of the local market? What documents will you be required to translate, and what control do you want to reserve over the translation process? For example, is there a reason to have the legal documents translated because your prospective franchisee doesn't understand the English language or government filings require a translation? Or is there a reason to resist translation of the legal documents because permitting a translation will



TIP

expose you to more liability under the local laws? Will you translate manuals, marketing materials, and other operational documents that the franchisee and its staff need to operate? Under those circumstances, will you shift the cost of translation to the franchisee? What are estimated costs of translation in your deal, and how do you build that cost into your deal budget or fees you are charging the franchisee?

If your franchisee is authorized to translate some of your documents, like your operations manual, have those documents independently translated back into English to better ensure the documents your franchisees will be using are accurate and align with your franchise system.

- » **Training and support:** How will you revise your training program to fit into the local market's culture and traditions? Will you customize your training program for the local market? Training will be your first substantive operational contact with your franchisees. Training is critical because your franchisees will need to train their staff. Do your best to avoid offending your audience and strive to make a good impression. For example, if you conduct physical training programs in a local market for a fitness franchise with a majority Muslim population, you may consider having separate training sessions for men and women led by persons of the same gender. It could be offensive for persons of opposite gender to have physical contact with each other in the local market.
- » **Local laws:** Will local laws impact your expansion efforts, brand identity, costs or revenue streams? For example, how will local taxes affect the fees that you collect? Can you protect your intellectual property rights in the local market? What exchange rates will you designate, and what restrictions exist that may affect how you receive your fees and other income in the U.S.? You will need the assistance of an experienced attorney and tax advisor to evaluate the impact of the local laws on your deal. See the upcoming section "Understanding the necessity of hiring an experienced attorney."
- » **Legal and other transactional costs:** Have you accounted for legal and other transaction costs? International expansion requires extensive due diligence, complex legal documents, and regulatory compliance. For example, international franchise deals are sophisticated, requiring numerous rounds of letters of intent and proposals. Costs can add up between drafting and negotiating letters of intent and preparing the final agreements. International deals can take weeks, months, and sometimes years to negotiate — be sure you understand the costs, which can vary depending on the requirements of the local market. For example, entering into a market in which English is practically the first language, U.S. currency is easily available, and where there are no country-specific disclosure laws or government registration requirements or other business restrictions will be much less expensive than entering into markets with these significant barriers to entry.

Investing capital

To do all of the preceding points well, having money or access to available capital is a key ingredient. Getting the return on your investment in the form of franchisee-paid royalties will take a lot of time and effort, and as we've already indicated, sometimes doesn't happen at all.



REMEMBER

The one truism of international expansion is that despite your best planning, you can count on it taking longer and being more expensive than you had planned for.

Sound business planning is critical to determining what you will need to invest in your international franchising program in order to reap the revenues your financial projections may show are possible. Your financial projections must reflect an accurate picture of your current and likely future revenue and expenses, incorporating a variety of different scenarios and assumptions, because the market can move fast and you will need to react quickly to its demands.

A few factors that could greatly influence your and your franchisee's costs to operate in international markets include mandatory higher wages and employee benefits, lack of real estate or sites that can accommodate your business, cost of space, including requiring up-front *key money* (up-front money paid to landlords to obtain a lease) in many countries, the lack of reliable suppliers and available ingredients or raw materials, and even the cost of money — including the exchange rate and tax consequences of franchisees paying fees to you in the U.S. See the earlier bullet point “Supply chain and logistics” for points to consider related to import and export issues.

And although jetting to Venice may sound glamorous — and a romantic ride on a gondola is very appealing — be prepared to invest lots of money to kick off and sustain a well-run international franchising program. Don't plan on receiving high international franchise or territorial development fees from your international franchisee to be available to use as capital. International franchisees have many more choices among brands than they used to, and the days of paying premium franchise or territorial development fees are gone. You should expect international franchisees to aggressively negotiate initial fees and other elements of your term sheet. Compared to domestic franchise expansion in the U.S., international franchise deals are highly negotiated. In the end, the amount of the fees you will be receiving will likely closely resemble your U.S. fees.

Given the distance and time required in securing an international deal, you will also need to factor into the negotiations of your initial fees (or an initial franchise application fee) the costs for finding, vetting, and conducting other investigations on prospective international franchisees. The reality is that making money on your international operations, even if you do it right, will usually take several years. Being patient is always a good idea in selecting franchisees, and given the

scope of what you are trying to accomplish internationally, it's even more so in vetting your international franchisees.

Franchisors can expect to visit potential foreign markets many times. You will need to conduct demographic studies on population size, education, per capita income, standard of living, and religious and cultural issues. You will have to determine whether the local population will buy your products or services based on demographics in the U.S. or if those demographics are different in the local market. You must eyeball the local and foreign competitors who are in the market. Each of them and those to come will impact your potential market share, site selection, marketing, and labor and supply issues.

In selecting your international markets for expansion, as we mentioned at the beginning, the same rules of the road that you use for domestic franchising will apply. Targeted growth is far better, more profitable, and easier to manage and support than a scattered strategy. Therefore, looking at your growth opportunities regionally makes sense because it lets you also determine what other countries in the area should be targeted for growth and in what country you should establish your support operations, if any.



REMEMBER

Expect to meet with potential international franchisee candidates on their turf. Having the prospects come to your headquarters or for a store tour of your chain in the U.S. is also advisable. Deals usually happen after a relationship based on trust and common goals has been built. Educate yourself to be culturally sensitive — even well-meaning franchisors have lost deals after failing to truly get to know the prospect and the market.

For example, Japan's business culture has a conservative dress code, commanding business suits and minimum jewelry. Politeness is also paramount in Japanese business meetings. Many a relationship has started off on the wrong foot simply by not understanding how business cards should be exchanged. In Japan, you should graciously accept business cards with both hands and attentively read them.



TIP

You will be selecting your international franchisee based on any number of factors and you will want to be certain that they meet your requirements. We recommend that during the courtship process you have the international franchisee prepare a business case on themselves, their company, their market, and the economics of the business they expect to operate. Having them make a presentation to you will give you a good understanding of whether their approach to protecting and enhancing your brand fits with your needs and expectations.

Working with third-party intermediaries

Exploring the international landscape can be risky. There are experienced international franchise consultants like MSA Worldwide (www.msaworldwide.com) that

can help you research international markets and identify prospective franchisees. The U.S. Department of Commerce's Gold Key Matchmaking service can also assist you in identifying and vetting prospective franchisees (www.commerce.gov/tags/gold-key-matchmaking).

Franchise consultants or advisors are useful in helping you develop your international franchise expansion plan, including the creation of your negotiating positions, sometimes called a *negotiating box*. The benefit of working with an experienced international consultant is that a consultant will help you in assessing the structure of your offering and the markets you will be able to support based on your existing domestic or international operations.

The negotiating box is an essential tool in most international programs because it enables your negotiating team to understand the parameters of what is negotiable, what isn't, and the limits of your flexibility. Franchise consultants typically charge a consulting fee for their services, work exclusively for you as part of your deal team, and can help you identify prospective franchisees.

In addition to working with an international consultant, you may also include franchise brokers as part of your expansion team. In contrast to consultants, brokers usually earn their fees through commissions and represent numerous franchisors that authorize them to market franchise opportunities. The role of a broker is to sell franchises. One benefit that brokers bring is that, if a candidate isn't right for one of their other clients, they may be able to shift that prospect to your opportunity. The opposite is also true: A broker could persuade a candidate interested in your opportunity to consider another franchisor should your negotiations slow down and the broker thinks their commission is at risk. Because brokers also call themselves consultants or advisors, you should understand their unique role and whose interests they represent.

Here is a list of important qualifications that you should ask about, whether you work with an international franchise consultant or broker:

- » **What is their expertise?** Ensure that they have a track record of success in structuring international franchise programs and in finding and closing deals on franchises similar to yours. Ask for references from franchisors and franchise lawyers. Inquire into the depth of their sales and consulting experience. Dig into their qualifications to find out whether they are running a full-time business or providing these services between jobs.
- » **What is their professional reputation?** Do your due diligence and research them carefully. Find articles, publications, and news releases about them. Evaluate whether they are known as trustworthy and honest. Talk to their other clients and professionals in franchising that they've worked with. Understand how they are compensated for their services and whose interests they represent.



WARNING

If part of their compensation is a portion of your ongoing fees from a franchisee, you should avoid those relationships. Also if they are paid up front for locations yet to open, determine what happens to those up-front fees if those locations never open. This is especially true if the broker brought the prospect to you and has conducted the due diligence for you on them.

- » **What are their deliverables?** Narrow down the deliverables, measurements of success, and milestones. Determine whether they will have the exclusive right to “find” qualified candidates for you in a specific market, and if so, how many qualified candidates must you receive or how many sales must you close over what period of time? Make sure you understand how they will communicate with you and deliver client services.
- » **Do they understand the laws in the targeted countries?** Although brokers aren't attorneys, they will be representing you under the laws in foreign markets. Because they are acting on your behalf, it is essential that they represent you properly under the law and also in the style in which you conduct your business. Ensuring that they won't involve you in problems later on is essential. Understanding whether or not they will indemnify you for claims caused by their actions is important.

Budgeting for capital investment

International franchising requires a carefully planned budget for capital investments. Creating a solid budget will help you determine what portion of your franchisee fee will cover your *capture* cost (the cost of recruiting and closing a franchise candidate), your capital and adaptation costs, and how you will be dividing your direct costs between you and your franchisee. If you are using an indirect method of expansion such as master franchising (see Chapter 2) you will need to factor in how you will be dividing the continuing revenue and sharing in the costs of support. It is important for you to have a well-structured strategic plan and budget because you need to have a solid estimate of how long it will take to break even after entering into a new market. The following are some points to consider when budgeting for international franchising:

- » **Adaptation costs:** Adaptation should be a core component of your international franchising business plan. *Adaptation* is an intense process of adjusting your brand to meet the needs and wants of the local market. For example, adapting the marketing materials used in the U.S. will probably involve more than translating them from English.

You will need to consider adaptation for your Internet, software, POS systems, and training materials, including determining whether your U.S. business systems will transition into the local market. You will also have to prepare for any agreed-upon adaptation of your products and services to meet the tastes

and customs of the local market. Refer to the earlier bullet “Your products and services.” Also see the upcoming section “Considering the implications of language and culture.”

- » **Operational and human resources costs:** International expansion may require that you have a dedicated team devoted to internationalizing your brand. This effort will generally not be successful as an add-on to your domestic staff's roles if you are serious in growing your business internationally.

Once you enter a foreign market, your franchisees will need operational support, and depending on how you structure your international franchise offerings, this may require you to add to your franchise support team. Keep in mind: Your international franchisees will usually be on different time zones as well.

If you plan on supporting your international franchise expansion from your domestic offices, you should budget for dedicated domestic staff to assist with overseas operations outside of the U.S. If on the other hand, your approach is broader, and you plan on opening up international support offices to work with franchisees on a regional basis, consider the costs of developing and staffing the type of support office you will require. Also don't forget that you may require visas for your staff to work in some foreign markets. Travel, taxes, and other related costs will also be factors. Refer to the earlier bullet “Internal buy-in.”

- » **Recruiting, onboarding, and training costs:** You should prepare a budget to cover your capture costs (identifying, recruiting, and closing prospective franchisees). Your budget should include conducting comprehensive background checks and due diligence on each candidate, as well as any brokerage fees you expect to pay.

Your international expansion team will require good interpersonal skills that are adaptable to multicultural audiences. Be careful not to pack on non-recruiting tasks to your recruiting staff. They have the important task of recruiting the right international franchisees, and you shouldn't burden them with also scouting for real estate and other tasks when traveling abroad to meet quality candidates. Refer to the earlier bullet “Translation issues.”

There will also be an initial cost for onboarding and training your international franchisees. Even though they are a distance from you, they still need to be onboarded, trained, and provided with initial support, just like your domestic franchisees. Depending on your international franchise structure, that onboarding may require you to provide direct support. With the availability of advanced electronic communication tools, including webinars, video or cloud-based training, and other electronic support, it would be wise to consider use of these tools in reducing your costs while maintaining your brand standards. Make certain your staff is able to obtain the necessary visas to work in the franchisee's market.

» **Customs and duties costs:** As mentioned earlier, there are a number of sourcing and supply-chain kinks to work out before internationalizing your brand. In addition to the additional expenses and legal issues to consider, there are practical issues of timing. Depending on how you plan your supply-chain structure, getting the goods to another country on a regular basis sufficient to meet local demand comes with some challenges to consider. You will need to budget for those costs. See the upcoming section “Product sourcing.”

» **Development and real estate costs:** Budget for the development and real estate costs in your international expansion. It will take time to identify appropriate locations, and you may encounter zoning, construction, or other laws that can be impediments to development.



TIP

One of the selection criteria most franchisors use to select international franchisees is their knowledge of the local real estate market. During your franchisee’s presentation to you in the recruitment process, make certain they have the skills and connections you will need in this area.

» **Legal and regulatory costs:** As mentioned, an international franchise deal is a complex agreement with numerous moving parts. Look back at the earlier bullet “Legal and other transactional costs” as you develop a budget for legal and regulatory compliance. Also, account for the ongoing legal fees you will incur while enforcing your system standards and franchisor rights. Although you will be relying on your domestic franchise lawyer for most of your advice, you should expect to also engage lawyers in the targeted countries. Sophisticated international franchise lawyers like your co-author Joyce Mazero understand international franchise deals and have a network of lawyers across the world with whom they have worked. You should rely on their expertise in this area in obtaining the proper international franchise advice. Your domestic franchise attorneys will coordinate your international legal matters with any local attorneys in the market you’re targeting. More information on legal matters is discussed in the next section, “Understanding the necessity of hiring an experience attorney.”



REMEMBER

Overall, you should do a line-by-line analysis of your accounting for your domestic operations and identify what those costs will be for your international expansion plans. Having a well-structured approach will go a long way to getting this important area right. It is one of the reasons that we recommend you engage the services of a recognized franchise consultant to help you work through all of the issues and not simply go to a brokerage interested in making the sale.

Understanding the necessity of hiring an experienced attorney

Legal fees can add up when registering trademarks, preparing franchise agreements, and satisfying legal requirements. Contrary to popular belief, the U.S. isn't the only country heavy with franchise laws. Other countries also have similar laws requiring a franchisor to provide a disclosure document to the prospective franchisee and in some cases, make filings with the local government authorities. Even if a disclosure document isn't required in the country you are entering, smart prospects used to evaluating U.S. brands will likely ask for one, so be prepared.

Failure to meet the legal requirements required by the country in which you want to expand and under your franchise agreement — including requirements related to disclosure requirements, withholding taxes, relationship laws, currency exchange restrictions, letters of credit, and dispute resolution — is easily avoidable if you get advice on your choices and how to navigate the legal environment from a qualified and experienced international franchise attorney. Some of the ways in which you approach many of these issues may be different from how you handle them in the U.S., but some will be similar or the same.



REMEMBER

Besides understanding U.S. and foreign legal requirements, attorneys experienced in international franchise law understand the nuances of how the laws are applied in each jurisdiction and can point out the traps that you can inadvertently fall into — even when you think you understand that country's law. When you are ready to cut a deal, you want to be able to move quickly.



TIP

If your current attorney is a novice in this area, you should request that they refer you to an international franchise lawyer with expertise in international franchise transactions. Experienced international franchise attorneys, both in the U.S. and in the local markets you are planning on entering — along with business consultants knowledgeable about international commerce — can save you time and money in correctly getting the deal done.

Many U.S. attorneys and consultants use a network of lawyers and consultants internationally that they respect and can also recommend to you. Here are a few good sources you can use:

- » The International Franchise Association's (IFA) Supplier Forum (www.franchise.org/supplier-forum).
- » The American Bar Association's (ABA) Forum on Franchising (www.americanbar.org/groups/franchising.html) can provide you with information on attorneys who specialize in international franchise law.

- » The International Bar Association (IBA) has an International Franchising Committee with over 600 members from 78 countries who regularly work in international franchising. You can reach the IBA, based in London, at www.ibanet.org.
- » Who's Who Legal, published by Law Business Research, Ltd. (<http://whoswho1egal.com>), can be used to search for lawyers specializing in franchise law around the world



PLAY THIS

You are going to need to get up to speed on new issues that you may not be familiar with and that aren't part of your current domestic franchise offering. The following is a list of common legal issues in international franchising that you should review with your international franchise attorney. A more comprehensive list of legal issues is available on this book's companion site (go to www.dummies.com/go/franchisemanagementfd):

- » **Currency:** Can you get paid in U.S. dollars? Do local laws restrict local currencies from being sent outside the local market? What financial institutions will you work with in transferring the funds so that you can get paid? Get a grip on your finances.
- » **Taxes, repatriation, and financial statements:** Are you and/or your franchisees subject to reporting and payment obligations? Have you structured your international franchising model to best reflect your tax liability and revenue needs? Have you determined whether you or your franchisee will be responsible for payment of local withholding tax? Do your financial statements conform to local requirements? There are numerous financial considerations that will impact your bottom line.
- » **Intellectual property:** Can you enforce your intellectual property rights in the local market? How much will it cost to register your trademarks abroad? How do you keep your secret sauce secret? Check out the country's protections for trade secrets and confidential information. Many countries have different approaches to enforcing intellectual property rights, while other countries have agreed to jointly protect intellectual property registered under terms agreed across those countries (sometimes called *conventions* or *protocols*).
- » **Competition:** Does your local market restrict or regulate business competition? Can you locally enforce your covenant not to compete? A local market's competition laws can significantly impact your franchisee's rights and may restrict your ability to enforce your standards or protect your franchise system in the market.
- » **Damages, liability, and indemnification:** Are *indemnification* agreements (provisions requiring a franchisee to defend and hold you harmless from money claims because of the franchisee's or a third party's actions)

enforceable in the local market? Will the local market uphold your *liquidated damages agreement* (a specific amount that is payable as damages by the franchisee instead of having a court or arbitrator decide the amount)? These liability concerns should be reflected in your agreements.

- » **Governing laws and dispute resolution:** *Arbitration* is a primary method for resolving disputes internationally because arbitration awards are more easily enforced due to several international conventions supporting their enforcement. Do you know whether you can enforce arbitration awards in the country and under what conditions? What is the most advantageous place for you to conduct arbitration — should it be in the U.S. or a neutral country? In what language will disputes be resolved? What arbitration rules will govern the dispute? Under what circumstances will access to the courts be needed, and will a court judgment be enforceable?
- » **Guaranties:** Can you enforce your guarantee agreement? Was your guarantee agreement executed to be enforceable in the local market? For example, does your local market require that certain language related to liability be reflected in the agreement? Incorporate local law into your agreements.
- » **Executing contracts:** Have you thought about extra-contractual formalities? Does the local market regulate the formalities of executing agreements? There may be rules or best practices on how contracts are executed and who has authority to enter into agreements.
- » **Ownership, agency, and relationship:** Will you run afoul of any foreign or local ownership rules in your local market? Will your international franchise need to obtain a local partner to do business in the country? Do you or your franchisee have third-party contract rights that you should consider? Does the local market regulate the termination of the franchise relationship?
- » **Religious laws:** Are there any religious laws to consider that may affect the products or services your franchisee can offer, hours of operation, or location of the business?
- » **Corruption:** Are you informed on how the U.S. anti-corruption laws that you must abide by at home may affect your deal? Are you or your franchisee required to comply with trade, transparency, anti-money-laundering, and anti-bribery laws in the country?



REMEMBER

Although generally a U.S. franchisor doesn't need to provide an FDD to an international franchisee prospect under the FTC Rule, it is possible that disclosure may be required under your state law, so you should check with your attorney.

After you strike a deal, you are not going to take the money and run. You have to translate documents, marketing materials, signage, and training, and you have to schedule more on-site visits.

Considering the implications of language and culture

In the past, many U.S. franchisors naturally chose English-speaking countries as their first stop for international franchising. But more recently, many franchisors have abandoned the comfort of the English language and have more aggressively pursued the global economy notwithstanding the languages spoken.

“Often the affinity and acceptance of a brand in a market have no relationship to language barriers or political or religious differences,” says Michael Beacham, president of international operations, Darden Restaurants (parent company of Olive Garden, LongHorn Steakhouse, and other brands). “One has to look no further than the popularity of U.S. brands in the Middle East, and the former Soviet Republics to see this. Similarly, American brands have had difficult entry into markets that logic would seem to say they would enter with ease, such as Canada or the U.K. There is *no* common formula, and franchisors need to do the homework on each and every market they choose to enter.”

The opportunities and challenges of the global economy present the benefits of global revenue streams as well as some difficulties, some of which include (as already mentioned) complying with foreign market laws and legal systems, getting U.S. dollars out of the foreign markets, sourcing and finding locally available products meeting a franchisor’s standards, and more.

At a more basic level, unit operations can be significantly affected by a foreign market’s laws, such as employment laws, which may be more protective of employees, regulations affecting hours of operations, and site location and other laws imposing operational restrictions.

For example, consider a franchisor that operates a food delivery business in the U.S. and the problems their international franchisee would face in navigating delivery systems in the crowded streets of Japan by moped. This scenario raises additional issues about security and the safe handling of food that is meant to arrive hot and ready to eat.

Consider also that some brand names mean one thing in the U.S. and something different in a foreign market. Remember the car named Nova? In Mexico, *no va* means “doesn’t go” — not a great message to someone wanting to buy an automobile.

As a result of local laws or customs, many companies choose or are required to change their names. Consider that because of the laws in Quebec, KFC is known as PFK in Montreal — PFK stands for *Poulet Frit Kentucky*. When Church’s Chicken entered Dubai, it did so under the brand name Texas Chicken — likely for obvious reasons.

Similarly, some food or beverage products may be offered in a foreign market and not in others for religious reasons. For instance, during Ramadan, a holy month of fasting observed by Muslims, franchisors like McDonald's make adjustments to their Middle Eastern menus, by offering dates, milk, and cookies.

In other markets adaptations are made to cater to local tastes. For example, in India, Taco Bell adapted its menu to the local palate by including items like extra-spicy burritos filled with paneer, a rubbery fresh Indian cheese. McDonald's localized its menu by offering items such as the McKroket in The Netherlands, which is a fried beef croquette on a bun. In the Middle East, franchisors are obtaining certification to serve halal food, which denotes meat prepared as prescribed by the standards of Muslim religious traditions. In Kenya, when KFC opened its first location in Nairobi, in addition to a slightly different menu offering, the food served was halal, and the location was designed to better accommodate a Muslim consumer's preferences.

Still other products and ingredients need to be changed because of local problems with ingredients. In Japan, for instance, some of the ingredients used in pancakes in the U.S. are prohibited because the Japanese government believes they may be factors in causing Alzheimer's disease. Other products not consumed in the U.S., like certain animal parts, are normal parts of the diet in other countries. Portion size may also need to change, and hours of operation may need to be adjusted to align with local requirements. And again, emphasizing the importance of your supply chain, you need to know whether there is a reputable source for ingredients or raw materials available in the foreign market that is necessary to make your product — or if not, you need to figure out where such items can be obtained, at what cost, and how the timing of delivery and the cost of storage may impact your franchisees.

Lots of factors can come in to play. Available real estate meeting specified square-footage requirements may be somewhat limited in a market and require downsizing of units and redesign to use more of the vertical space that is available at the site. You will also have to consider the availability of technology in implementing a POS or other financial reporting systems that you use in the U.S.

“International franchising growth can be fraught with peril. It runs the gamut of the tangible and intangible,” Liam Brown, president, U.S. and Canada, of Select Service & Extended Stay Lodging and Owner & Franchise Services, North America Marriott, International, and first vice chair of the International Franchise Association. “Local culture and local politics can seem an impenetrable maze. Regulations can often be very different to regulations in the U.S. and with a very different emphasis on outcomes. The franchise model is also at various stages of incubation outside the U.S., so be prepared to invest more time in educating and training of those who will be trusted with your marks. And time. It can take an awful lot longer than you think. So invest in the long term because it can take many years to gain size and momentum.”



TIP

Many aspects of unit operations will need scrutiny so that you will better understand to what extent your franchise system will need to be modified in order to properly operate in certain foreign markets. You can ask your franchisee when they make their presentation to you to go through their recommendations of any changes they expect will be required in their markets. Keep in mind, while your international franchisee may recommend a change, unless it is something you agree with, or something required under local law of custom, you are not obligated to modify your franchise offering.



WARNING

There are laws in the U.S. primarily focused on restricting U.S. persons from conducting business with persons and countries associated with the sponsoring of terrorism and the spread of corruption in global business dealings. Some countries that have been restricted in the past now permit some expanded U.S. development activities. Other markets are not available to U.S. companies and are listed in databases maintained by the U.S. government. Refer to the earlier bullet on “Local economic issues” for more information on how the U.S. Department of the Treasury’s Office of Foreign Assets Control (OFAC) administers and enforces economic trade sanctions, and maintains lists of specific individuals and countries with which U.S. persons can’t conduct business. Make sure that you work with your attorney to conduct the appropriate due diligence on your international prospects.

The reality is that many franchisors either forget or fail to fully appreciate the work required to build their brands. International expansion is as close as it comes to pioneering your brand in a new world. Therefore, it compels the franchisor to prove its concept and products in every foreign market that it selects.



REMEMBER

Today all brands are local. A few years back it was reported that the meat being served by a well-known U.S. franchise brand in the E.U. contained some horse-meat. While the report did not make the front pages in Europe, overnight the information circulated globally through Yelp and other media sites. The news impacted the sales for the company’s U.S. franchisees. Everything today is local.

Getting your money out

Local taxes and laws will impact your revenue. Taxes may also materially affect the amounts that you actually receive, and you should review the likely tax impact of your international expansion plans with your attorney. An experienced attorney can help you reduce or eliminate your liability, including tax liability, in foreign markets and increase your expected revenue.

Depending on the country, you may also face currency-exchange restrictions and rate fluctuations on the return of profits or payment of royalties to you from the franchised business. One company to consider speaking with about facilitating

your international funds transfers is AFEX Global Payment and Risk Management Solutions (www.afex.com/unitedstates/).

Product sourcing

Not every country has the products your franchisees will need, when they need it, at an affordable price. Sourcing locally is normally ideal. But you will need to do advance work to determine whether suppliers in the local market can provide products that meet your standards, including protecting your trade secrets, if it is necessary for you to provide the supplier with confidential information about the ingredients of your secret sauce.

Speaking with other franchisors who are conducting business in the foreign market can be enlightening because they may be able to provide you shortcuts on solving problems that are common in many markets. The U.S. consulate and business services representatives can also be helpful in identifying and vetting sources for raw materials and products.



TIP

You will need to monitor ongoing compliance by the suppliers in the foreign market and include it in your overall investment costs for expanding internationally. The U.S. Department of Commerce's International Trade Administration collaborates with 19 U.S. government agencies to run the website www.export.gov/welcome, which assists U.S. businesses with planning, developing, and executing international sales strategies. On this site, you can request commercial assistance for a fee from a U.S. embassy or the U.S. and Foreign Commercial Service in golden key services, international franchisee searches, international company profiles, and customized market research.



TIP

In addition, the World Bank offers free tools to assist in researching a foreign market (www.worldbank.org). The first tool is an online open access data platform to research global development data. The second tool is its Development Economics Group (DEC), the premier research and data arm of the organization. The DEC publishes numerous comprehensive global development reports. For example, check out the DEC's Doing Business project (www.doingbusiness.org), which provides objective measures of business regulations in 190 economies and selected cities at a subnational level. Similar market reports are published by the International Finance Corporation (IFC), a member of the World Bank Group (www.ifc.org).

Protecting trademarks, trade secrets, and other valuable brand assets

Carefully evaluate countries with loose trademark, trade secret, copyright, and patent protection laws. Countries like those referred to as the BRIC countries

(Brazil, Russia, India, and China) remain challenging, and any franchisor needs to appreciate the lack of protection for U.S. intellectual property assets that still exists in those regions. Organizations like the World Intellectual Property Organization (WIPO) are working hard to provide worldwide access to intellectual property protections, systems, and policies. Visit WIPO's website at www.wipo.int/portal/en/index.html.

But a franchisor is still at risk of being knocked off or copied without efficient or economical recourse. Consult with your attorney to evaluate the steps required to protect your intellectual property assets, including timing and cost of registering your primary trademarks and other important intellectual property. Because some countries' trademark laws grant trademark rights to the first party to file for trademark protection, trademark pirates may have already registered your brand name under your nose, hoping that you will pay them to get it released to you. There are also region-wide conventions that you can consider to provide you with multi-country protections. Also, timing is important because in some cases, use of the trademark or patent prior to registration may preclude or diminish your ability to get the protections afforded by the law.



WARNING

Although it may seem like a helpful suggestion, don't allow any franchisee to file for your trademark and patent protection in any country. You may find that they and not you own that name in their country.

Depending on what country you choose, you may need to be concerned with other laws that are not necessarily franchise-specific but that may apply to your franchise transaction anyway. These include laws that prohibit certain unfair or uncompetitive practices and agency laws that can be applied in some countries to protect a franchisee against termination and give the franchisee rights not contemplated by your franchise agreement. See a more comprehensive list of legal issues on this book's companion site. Go to www.dummies.com/go/franchisemanagementfd.

Decisions, Decisions: Whether to Make the Leap

The answer to the question of whether a U.S. franchisor should expand internationally really depends on timing. Clearly, a saturated domestic market is a strong incentive to go looking outside the U.S., but that incentive alone doesn't necessarily mean that the franchise system is ready for international expansion. International franchising isn't going to solve any of your problems in the U.S. and may actually create additional problems for you.

Smart franchisors expand internationally only after intensively planning for their expansion and only after assessing whether they have the resources and capabilities to properly support franchisees in foreign markets. This section sets out some key points for determining when international expansion is right for you.

Before entertaining international proposals, a franchisor should have a strong and profitable base at home. To do otherwise is like serving dessert before the main course. We can't pinpoint an exact number of units a franchisor should have operating, but your domestic operations should have a significant number of franchisees operating successfully in various regions throughout the U.S. You should have a proven capability of being able to fully support your domestic operations, and your U.S. operations should be fully supported from domestic royalties before going international.

Internally, a franchisor's executive management team should be committed to the brand for the long haul. Too many international franchise programs are disrupted when franchisors pull back or substantially reduce resources for the international expansion program because early results fall short of (often unrealistic) expectations.

Long-term commitment to international franchising includes shifting or adding staff that solely focus on the international franchise expansion program. Having field staff, marketing support, product sourcing, operations, and training staff all dedicated to international expansion with the support of the rest of the organization isn't unusual. As international operations grow, you may need to establish an international organization that mirrors your domestic organization. Franchisors also need to have a surplus of capital resources for providing support services, modifying operations, and making on-site visits.

Having a successful launch of your international expansion program requires you to recognize the necessary differences between international operations and your domestic operations. For example, no training is universal. You will need to weave adaptations into your standard training for operational variations and cultural differences, as well as address the training that your franchisee will provide to its staff. Even if you don't use cloud-based training programs at home, consider developing them for your international markets to ensure that your franchisee has the tools necessary to train their own personnel.

If you offer franchises to master franchisees that will select and provide support to franchisees in their markets, you need to train the master franchisees on how to be "franchisors." Your master franchisee will be performing many of the same tasks you do as a franchisor, such as franchisee selection, training, consulting, and support. The master franchisees will need training in the following key areas:

- »» Recruiting, vetting, and selecting franchisees
- »» Administrative functions
- »» Site selection
- »» Marketing and advertising
- »» Training for personnel who will be trained locally
- »» Local product sourcing and vendor management
- »» Standards enforcement and discipline procedures
- »» Managing franchise relations, including when and how to default or terminate errant franchisees



TIP

It will be important for you to appoint one key person or group to be in charge of international franchise expansion. It is a full-time job — and it can't be achieved successfully on the fly or in your spare time when you are not focused on your domestic operations. So many times, franchisors let their focus stray from their domestic business — the very thing that got them where they are in the first place. They mistakenly get caught up in the excitement, which can sometimes border on fantasy, of going global. Make sure you have the organization to manage both domestic and international commitments adequately — or wait until you do.

Look at the flip side for a moment. Don't pursue international franchising if

- »» You are looking for a quick fix to cash-flow problems.
- »» Executive management isn't committed to long-term development.
- »» You are not prepared to invest time, effort, and resources.
- »» Your product or service doesn't meet the foreign market's needs.
- »» You are unwilling to or can't modify your product or service to the foreign market.
- »» You can't secure trademark protection.
- »» Your operating procedures are so rigid that you can't or don't want to accommodate cultural or legal differences or requirements.
- »» Political or economic instability will create problems.
- »» You can't get your money out of the country.

If You Decide to Cross the Border

If you decide to take the plunge, you want to tread carefully as you try to find your initial franchisees. You want to select a franchisee who has expertise and experience in the foreign market to structure a business relationship that provides the optimum benefits to you and the brand.

Finding the right franchisee

So, you have your passport in hand? Not so fast. A big part of implementing an international franchise expansion program involves teaming up with the right franchisee. First, consider that U.S. franchisors typically expand internationally in three ways:

» **Master franchising:** A master franchisee is granted rights to open units pursuant to a development schedule that calls for x number of units over x number of years. The master franchisee operates their units or sub-franchises to qualified franchisees, or to both. As a mirror image of the franchisor, they provide support to their sub-franchisees on the local level in exchange for a percentage of franchise fees and royalties paid by the sub-franchisees.

Although master franchising was historically the most popular way for franchisors to expand internationally and is still used today, master franchising is no longer the primary expansion method. The Internet, intranets, and other modern communications technologies today allow franchisors to set standards, monitor the performance of their international franchisees, and provide them with a significant amount of support. By avoiding master franchising, a franchisor is able to retain much of the revenue it would need to share with its master franchisee.

» **Multi-unit development:** A multi-unit developer is granted rights to develop units pursuant to a development schedule in a geographic area with some territorial protection from development of units by the franchisor or other franchisees (no sub-franchising is permitted) and relies on the franchisor for support services. The structure of this relationship is almost identical to that found in use for domestic multi-unit franchisees.

» **Joint ventures:** In a joint venture, a franchisor and a local franchisee form a venture company to pool their expertise and cash. This option gives the franchisor both more control and more risk. But the franchisor's equity participation may make a deal more credible to the local franchisee and to the government and banks, among other stakeholders.



WARNING

Joint venture agreements can be tricky and require care in how they are structured. Issues include the extent of the authority of the joint venture franchisee partner to obligate or incur liability on behalf of the joint venture and to acquire or dispose of assets. Joint venture relationships require working with legal counsel experienced in these relationships.

Not just any warm body will do when you are looking for a franchisee. The biggest reason international franchising attempts fail is poor matchmaking — such as selecting a franchisee who is undercapitalized, is inattentive, doesn't adhere to a development schedule, or wants to operate your brand in their own way.

Distance makes international franchising difficult as it is, and the complications of trying to effectively communicate over time zones and several oceans enhance the difficulty even further. Nipping a problem in the bud is more difficult and more costly when you are thousands of miles away and in a different country. By the time you find out about the problem, it may be too late to problem-solve. You could spend more money than you were paid straightening it out — or litigating it.



REMEMBER

In looking for an international franchisee, trust should top your list of qualities in a candidate. You are entrusting this person to build a network, protect and grow your brand name, and uphold your standards. You want some assurance that this person will put his or her heart and soul into the deal. What you may not want is a large institutional franchisee swimming in so many directions that your franchise drops to the bottom of their ocean. Your brand deserves capital and staff to support a development schedule, and your brand deserves focus. An international franchisee with access to real estate and local suppliers are key success ingredients. If your joint venture partner is up on franchising, all the better for you.

Internationally, your franchise prospect may differ from the candidate you typically look for in your home market. The prospect may be bigger and better financed, and they may have more resources and more bargaining power. This has its minuses as well as its pluses. You may consider (or even target) the type of franchisee you may not necessarily target in the U.S., including a portfolio company operating multiple brands.

Entering a foreign market

Just as it is in the U.S., every franchisor wants to find and attract the best-suited franchisees for their franchise system — efficiently and effectively.

The first prospect isn't always the best choice, so be sure to consult with your attorney or consultant on how to conduct a reasonable background investigation on the prospective franchisee. Your professional advisors can advise on identifying standard data you would want to know about any prospective franchisee, such

as business experience, education, and sources of funds for capital, litigation history, and bankruptcy, banking, and business references. The type of information and data available may be lacking in some countries, and in others, the information is available but not in a single place.

You will need to determine the best method to obtain information, including having your prospect execute a franchise application permitting you or an investigatory firm on your behalf to obtain that information from third-party sources like government offices, banks, and other information-gathering firms. Fees for investigatory firm reports should be incorporated into the initial fees you obtain under any preliminary agreement that you enter into with a prospective franchisee for a franchise in a foreign market. Depending on the country you are targeting, you can obtain some information from the U.S. consulate or embassy.



TIP

Check out the International Trade Administration's (ITA) Industry & Analysis (I&A) unit (www.trade.gov). The role of the I&A unit is to synthesize the ITA's industry, trade, and economic expertise to advance the competitiveness of U.S. industries through developing and executing international trade and investment policies and promotion strategies.

Don't be surprised if you have a lot of U.S. as well as foreign-based competition for the best franchisees. Foreign franchisors are franchising with increasing frequency — in their home countries and abroad.

To begin your search for prospective international franchises, try the following sources:

- » **Trade missions:** The International Franchise Association (IFA) organizes trade missions (<http://franchise.org>). These missions last five to ten days and span two to four countries. They include meetings at U.S. embassies and one-on-one appointments with potential investors, prescreened to meet your requirements for a franchisee.
- » **Trade shows:** The annual International Franchise Exposition (IFE) held in the U.S. typically draws thousands of foreign visitors in search of franchise opportunities. Contact the exposition's producer, MFV Expositions (MFV) (www.mfvexpo.com). MFV also sponsors franchising events in other countries, where U.S. franchisors can learn from local professionals on topics like how to enter the country, and foreign franchisors are able to learn from U.S. franchising professionals. Find more information about MFV in Chapter 6.
- » **Embassies:** Government offices in foreign countries can help you network and qualify prospective candidates. You can also try U.S. chambers of commerce and industry associations. As discussed earlier in the "Product sourcing" section, the U.S. Department of Commerce's International Trade

Administration collaborates with 19 U.S. government agencies to run the site www.export.gov/welcome to assist U.S. businesses with entering into foreign markets.

- » **Referrals:** Contact franchise consultants and attorneys with affiliate offices in foreign countries. Franchisors of non-competing concepts may also be willing to share leads. Give them a call.
- » **World Franchise Council:** The World Franchise Council (WFC) is made up of approximately 30 national franchise associations in many countries (www.worldfranchisecouncil.net). The council's purpose is to encourage international understanding and cooperation in the protection and promotion of franchising worldwide. Many of the WFC's franchise association members or the members of those associations host local franchise trade shows during the year. When exploring how to enter a foreign market, these local associations can provide you information on the market and let you know the dates of any trade shows that may be coming up.

Negotiating the deal

If you think you can saunter in and crank out a franchise agreement like you do in your home market, forget it. If you're used to saying, "Take it or leave it" at home, don't expect this approach to get you far on the international scene. Negotiation is definitely the name of the game in international franchising. Because you're usually dealing with larger territories and big front-end fees, much more is at stake — for you and your prospective franchisee.



REMEMBER

As discussed earlier, you should work with an experienced franchise consultant in developing for you a negotiating box. This will facilitate your negotiating strategy and let your marketing team understand the parameters of the deal that is acceptable to you. It is essential to decide up front which issues you would be willing to negotiate and which you won't.



TIP

Working with an experienced international franchise attorney to prepare baseline agreements will allow you to quickly adapt the agreements to what has been negotiated, reflect the legal issues relevant in your target country, and incorporate best practices for that country. The key to negotiating is building a trusting relationship. Make sure that the international franchisee completely understands his or her obligations — and that you understand yours. Because of potential language barriers, review everything — and then review it again — to avoid miscommunication. You should always strike a balance, though. The key isn't to give away too much of your positions so you don't materially change your franchise system.

Keep cultural differences in mind when negotiating. People frequently want to establish friendships before getting down to business. Also understand that in many cultures a *yes* only means the other party is willing to continue negotiations and isn't accepting your terms.

Your flexibility should depend on your thirst for the deal and that particular franchisee. If a prospect is thinly capitalized and lacks experience, you don't have much reason to bargain. When in doubt, walk. But if your prospect is well capitalized, has sources for products, owns real estate perfect for your concept, has a great reputation as an ethical businessperson, and wants to open multiple locations, the prospect may be worth pursuing negotiations with.

Even with experienced international franchisees who feel that they are bringing a lot of value to the table, don't be surprised if your fees are a bone of contention. Your asking price should reflect your size, your trademark, and your expenses. Reducing your fees may not be in the best interest of your future relationships. Smart franchisors throw the following items on the table to make the front-end fee more palatable:

- » Extra training
- » More on-site support
- » Translation of materials
- » Additional advertising support
- » Discounts on the initial inventory



TIP

This may seem like common sense, but don't sign any agreement that isn't in English. There have been instances where foreign language agreements have been signed containing terms the franchisor did not know they were agreeing to. Normally, if an agreement is required to be translated into another language, a dual-language format agreement is prepared so the parties sign the dual-language version. This dual-language agreement will contain a provision indicating that in the event of conflict, the English-language version will prevail. This provision isn't always effective, especially in courts in the target country, but it will be useful in arbitrations and dispute negotiations.

Building in growth incentives also works as a bargaining chip. You might consider reducing royalties based on the franchisee exceeding sales targets, or offering lower per-unit fees for surpassing development schedules.

You should determine in the agreement a precise number of units that your multi-unit developer must build before bringing on other investors. If you choose master franchising, you should stipulate the number of units that your master franchisee

must build and operate directly before they can begin to sub-franchise. Resolving operational challenges in the master franchisee's units will better ensure there is a pilot operation available for training.

Other contract issues include non-competition covenants, termination rights and post-termination obligations, supplier restrictions, local insurance requirements, exclusivity and territory agreements, development obligations, transfers, indemnity, guarantees, fees and payments, required services, products and menus, tax liability, and governing law. There are also extra-contractual considerations, such as formalities in executing valid contracts, operating permits, notarization, and complying with requirements prescribed by local authorities.



TIP

Dispute resolution is a big topic everywhere. Although many of the same methods available for resolving problems in your home country are likely available in foreign markets (arbitration and mediation) — let your attorney guide you down this path. Understand that it isn't sufficient for you to win any legal dispute. The award or judgment needs to be enforced, and care should be taken to ensure you will be able to enforce the award or judgment under applicable treaties and conventions.

Striking a deal is just a small first step. The giant step is making the deal work. But the two go together because, for the deal to work, you must be satisfied with a deal that makes economic sense. If your ego demands a press release announcing a huge franchise fee and aggressive development schedule, you may be headed for trouble. Remember that the franchisee will need resources to meet their obligations. Temper your expectations. Keep in mind that their money may no longer be available immediately after paying you such a large fee. Make sure you are planning for the future success of your business.

Just as you do at home, make sure you select franchisees that have the resources necessary to do their jobs. The bulk of your income should come from continuing fees from a growing network of locations and not from a one-time payment.

Bringing Foreign Franchises to the United States

Although many Americans may not realize it, the U.S. isn't the only mother of invention. Companies worldwide are giving birth to their own franchised concepts, and with increasing frequency they are crossing borders and offering franchises all over the world.

Because of its size, the U.S. market is extremely attractive to many foreign franchisors. Americans also have a deep-rooted fascination with franchising and relatively high disposable income and enthusiastically embrace new products and services. We are also the consummate consumers — just check out our credit card debt!

The biggest problem for foreign franchisors is fear. They fear being sued because of the U.S.'s reputation for litigation. Furthermore, foreign franchisors know that playing the game in the U.S. requires investing a lot of money, because of the regulatory environment, and they are often daunted by the size and diversity of the market.

Foreign franchisors often offer master franchises or set up joint ventures, when entering the United States. That's not surprising because they have seen U.S. franchisors using master franchising in their home countries. But this likely is not the most productive way to expand in the U.S. because master franchising is rarely used by U.S. franchisors at home.

Foreign companies entering the U.S. need to understand the U.S. market and answer the same key questions we posed for U.S. franchisors going overseas. Even if foreign franchisors are convinced that the concept will work in the U.S., they could drain their financial resources if they miss the mark.

Working far from home presents challenges that foreign franchisors have to be ready for in the U.S.:



REMEMBER

- » Will you adapt the concept to the local market? Who will control the adaptations? Who is your local consumer and competition?

Unlike many foreign countries, the U.S. isn't a homogeneous market. It is also a very sophisticated market and readily adopts foreign concepts. Care should be taken, therefore, in changing a brand offering based on some perception that Americans shop in any unified way.

- » Are inventory and equipment available locally? If you must import them, what are the duties, shipping costs, and time constraints?
- » Will you store inventory locally to make up for potentially longer delivery times to your franchisees of the products and supplies they will need?
- » Does your brand have enough name recognition to demand a higher price — especially compared to local competition — to cover any increased costs?
- » What happens if things don't work out?
- » What are your termination provisions and dispute resolution procedures?

- »» What is your corporate culture like? Do you have open communication? How will you communicate with franchisees who speak a different language from the language spoken by everyone else in the system?
- »» How will you get paid, and are you required to pay taxes, and if so, to whom must you pay taxes?
- »» Can you enforce your core rights related to payments, termination, and intellectual property?

Just because a franchisor is from overseas doesn't mean that it doesn't have to meet all the requirements of a domestic franchisor. If a franchisor is offering franchises in the U.S., it must provide an FDD (see Chapter 5) and may be required to satisfy state franchise laws as well. Just as with U.S. franchisors going overseas, franchisors entering the U.S. should work with U.S. consultants and an experienced franchise attorney.



REMEMBER

The U.S. can be a tough and unforgiving market. Historically, few foreign franchisors, including those from nearby Canada, have prospered in the U.S. The size, costs, diversity of markets, and different culture of the American franchisee and consumer often overwhelm foreign franchisors. Plan on testing your concept first in a local market with a company-owned location. When you begin to expand, broadly test a market like Dallas or Chicago, which could provide you with a good opportunity to check your ability to support multi-unit development before expanding further in the U.S.

IN THIS CHAPTER

- » Getting a sense of what social franchising is
- » Focusing on the base of the pyramid (BOP)
- » Overcoming social franchising challenges
- » Checking out CFWshops, a fine example of a social franchise
- » Finding resources for social franchises

Chapter **17**

A World of Good with Social Franchising

Let's start with the basics. Commercial franchising and social franchising are variations on the same basic strategy for expanding a business. They differ in just two ways:

- » The type and purpose of the products and services offered by the business being franchised
- » The profile of the target customer

MSA Worldwide, the franchise consulting firm your co-author Michael Seid founded in 1987, has established a practice group to work with social franchisors, NGOs, social investors, and donors (www.msaworldwide.com). According to Julie McBride, senior consultant, social franchising for MSA Worldwide, "Social franchised businesses, like those operated by traditional NGOs (nongovernmental organizations) are primarily developed to offer products and services that people need — not simply want — to live healthy and productive lives, including health-care, safe drinking water, sanitation, clean energy, and education."

These are businesses whose creation is targeted to achieve performance goals such as those set in the 2030 Sustainable Development Goals established by the United Nations (<https://sustainabledevelopment.un.org/sdgs>). “These are businesses whose customer base includes primarily the underserved segments of our global society,” McBride says.

With the exception of the different profile of the targeted consumer, social businesses and commercial businesses are quite similar. In contrast to the customer who walks into a McDonald’s or a Marriott or Dat Dog in New Orleans, the consumer targeted by social franchise systems often can’t afford to pay the entire cost of the goods and services they need. Because of that, social franchisors are usually unable to generate the royalty and other revenue and fees necessary to independently sustain the overall business.



REMEMBER

Being independently sustainable is the hallmark of commercial franchising. That is the significant difference between social and commercial franchisors.

Franchising is a way to achieve a social impact on a large scale because franchising achieves three key things that other methods of distribution don’t:

1. It standardizes what people do so that when they perform services they do it in a manner that achieves the result sought — such as effective quality care in the case of primary care.
2. Because it entails a standardized format, there is something to replicate. And scaling doesn’t just mean opening more locations but replicating a standardized unit.
3. If the first two are accomplished, then economies of scale may be exploited to bring down costs while standards continue to be met.

We stress these three things because the root problem in poor countries is that many things we might find as substandard in an industrialized world are acceptable because they are unavailable or in short supply. Unlike in rich countries, where standards drive the quality of most things in commerce, it is often the mere availability of the product and service that drives decisions at the *base of the pyramid* (BOP). The compliance with standards is what delivers the most social impact.

Social franchisors — although capable of achieving and replicating consistent brand standards and sharing in all the other performance and economic benefits found in commercial franchising — require subsidies at multiple levels to offset the cost of serving the difficult to reach and low-income customers (see Chapter 6). But in every other material way, commercial and social franchising are basically the same. In both commercial and social franchise systems, the following are true:

- »» The franchisor licenses to a franchisee its brand, system, and methods of doing business.
- »» The franchisee operates and manages their independently owned business to the brand standards of the franchisor.
- »» The end-user customer benefits from the consistency and quality standards set and enforced by the franchisor.
- »» The business owner (franchisee) is selected and supported by the franchise system.
- »» As an independently owned and managed business, the franchisee earns a living and creates equity for themselves and for their families.
- »» The franchise system creates jobs in the communities it serves.
- »» The franchise system creates consumer brand awareness, and its capability to be effective and economically efficient makes it competitive against the existing competition.
- »» Even though the franchise system requires a funding source to overcome poverty at the consumer level — and may also require subsidies to support franchisee development — at a foundational level, just as with any well-structured commercial franchise, social franchises are designed, developed, and managed to achieve financial sustainability.

It is the endemic economic difference in the markets they serve that creates the challenge for social franchisors. Instead of living off of the royalty and other continuing fees paid by franchisees from the local sale of their products and services, the franchise system requires substantial economic support from donors or other economic sponsors until it can create critical mass and achieve internal sustainability. Even though social franchisors have the capability of achieving their goals more effectively than a traditional NGO, the economic realities of the market they share are the same.



REMEMBER

An NGO is a not-for-profit organization that seeks to provide a variety of beneficial products and services and other humanitarian functions. An NGO is independent from any federal or other government organization.

Social franchising, like commercial franchising, follows a bottom-up business strategy where the local level business performance and the consumer are of paramount importance. Traditional NGOs — while also seeking to achieve socially beneficial ends by increasing access to products and services across a range of socially oriented industries — are more often top-down enterprises and don't have the same commercial focus, nor do they generally apply the same commercial methodologies or discipline. Still, both systems target markets that are generally underserved with populations in low-, medium-, and high-income countries around the globe. The primary focus of each is solving many basic societal needs for the world's population found at the so-called *base* or BOP.

WHAT'S THE DIFFERENCE BETWEEN A SOCIAL FRANCHISE AND A MICROFRANCHISE?

You will frequently see the term *microfranchise* used interchangeably with *social franchise*, but there is a difference. In a social franchise, the franchisor is targeting the concept to solving a social need, whereas in a microfranchise the franchise system is used to increase access to business opportunities that enable people to lift themselves out of poverty.

That said, a social franchise can also be designed as a microfranchise. This model is referred to as a *hybrid social/microfranchise*. Jibu (<http://jibuco.com>) and CFW (www.cfwshops.org) are examples of hybrid social/microfranchises. In a microfranchise, the investment cost for the business owner is usually minimal, and the potential for profitability is relatively high.

BOP: The Base of the Pyramid

Just as commercial franchising is an alternative growth and distribution strategy in traditional markets, social franchising is an alternative strategy to consider at the BOP. In many important ways, though, the tools and structures found in social franchises can be adopted by traditional NGOs to improve their performance, just as commercial franchising techniques can be used to improve the performance of other for-profit enterprises.

The term BOP refers to the people who live at the bottom of the wealth pyramid, who are in extreme poverty. Although the majority of the world's people living at the base of the pyramid today reside in developing countries, the term was originally used by Franklin Roosevelt to describe a segment of society in the United States at the height of the Great Depression in 1932 (www.presidency.ucsb.edu/ws/?pid=88408).

The similarities between the developing world today and the United States in 1932 are striking. In a radio address, Roosevelt spoke to the needs of the people who had lost their jobs, were poor and without hope. He spoke of the farmers unable to sell their crops at a price that equaled their costs and he laid out his plan for rebuilding the economy. How this relates to social franchising is the solution that he proposed to this challenge. He called not for charity to support the poor but

proposed an economic plan to rebuild the U.S. economy “from the bottom up.” President Roosevelt said in a speech called “The Forgotten Man”:

“In my calm judgment, the Nation faces today a more grave emergency than in 1917. It is said that Napoleon lost the battle of Waterloo because he forgot his infantry — he staked too much upon the more spectacular but less substantial cavalry. The present administration in Washington provides a close parallel. It has either forgotten or it does not want to remember the infantry of our economic army. These unhappy times call for the building of plans that rest upon the forgotten, the unorganized but the indispensable units of economic power for plans like those of 1917 that build from the bottom up and not from the top down, that put their faith once more in the *forgotten man at the bottom of the economic pyramid.*”



REMEMBER

It is estimated that there are approximately 7.4 billion people in the world today, with 4 billion living on less than \$8.25 per day. The BOP refers to the ones who survive on less than \$2.50 per day. Half the world’s wealth is controlled by 1 percent of the world’s population, mainly in developed countries. The remaining 99 percent of the world’s population shares the other half.

When plotted on a graph, the economic dispersion resembles a pyramid with the extreme poor being the largest segment, making up the base of the pyramid. The goal of developing economic opportunity at the BOP is not to transfer the wealth of the 1 percent to the 99 percent, because that is an illogical, unsustainable, and disproven method to achieve economic improvement. The goal of social franchising is instead the natural expansion of the economy in these markets sufficient to create sustainable and widespread opportunities for local and natural wealth creation.

Commercial franchising has already shown its capability to be a key ingredient in developing economic opportunity and transforming inner city communities domestically. Because of brand standards and the structures in a franchise that ensure the ability of a franchise to achieve and uniformly maintain those standards, economic opportunity and local wealth is created. In addition to the creation of local jobs, the products and services change the human dynamics in neighborhoods because the same consumer opportunities available in affluent neighborhoods are now available in their neighborhood.

Both NGOs and social franchisors may be able to deliver the same products and services to a community at the base of the pyramid. That is, both methods share a common mission. However, franchising, as a method of distribution, has essential attributes that are lacking in traditional NGOs:

- » Consistent, sustainable, replication in the delivery of the franchisor’s brand promise to consumers, possible because of the commercial systems that are foundational in its approach

- » The creation of wealth through supported local ownership of the businesses by franchisees and the jobs those formula entrepreneurs create

To be successful, a social franchisor needs to focus on the essential social mission it shares with NGOs, but it needs to deliver those goals using the business and legal standards and practices found in commercial franchising. The structures and practices we have discussed in this book that are necessary for successful commercial franchises are exactly the same as those needed for successful social franchisors.

According to the United Nations' 2014 Millennium Development Goals (MDG) Gap Task Force Report, "Essential medicines are available, on average, in only 55 percent of facilities in the public sector and 66 percent in the private sector (in selected developing countries)." In its 2010 Countdown to 2015 report, MDG estimated the following:

- » Nearly 9 million children under the age of five die every year.
- » Around 70 percent of these early child deaths are due to conditions that could be prevented or treated with access to simple, affordable interventions.
- » An additional 3.3 million babies are stillborn.
- » The leading causes of death in under-five children are pneumonia, diarrhea, and health problems during the first month of life.
- » Over one-third of all child deaths are linked to malnutrition.
- » Children in developing countries are ten times more likely to die before the age of five than children in developed countries.

To put these facts in context, more than 17,000 children under the age of five die from preventable causes each day, and scaling affordable, effective, and accessible healthcare is essential to solving this critical problem.

Scott Hillstrom, founder of CFWshops, a social franchise network of primary care medical clinics headquartered in Nairobi, Kenya, advocates the use of the franchise model as a means to incentivize providers to deliver effective, quality care in places where legal regulations are not enforced. He says, "Franchising is a way to set standards, to scale, and to achieve economies of scale. CFWshops serves 500,000 people per year — half in clinics and half in community health education activities — at a cost of only \$250,000 to fund the franchisor."

Franchising's goals include by necessity sustainability. In a commercial setting, the consumer has the economic resources to purchase the products and services offered, and many of those purchases are of non-essentials. In a social setting, the

consumer most often lacks the resources to purchase the products and services offered, and their purchase decisions are more basic. They are looking to purchase the essentials: medicines and medical care, food, clean water, and so on. Until the underlying economies at the base of the pyramid change, this consumer reality will not change. However, unlike the delivery of charity through a traditional NGO, social franchising's mission to create local wealth can be a significant ingredient in the necessary overall economic improvement in the markets.

The Challenges for Social Franchising

For social businesses to be part of the solution, they need to be scalable, affordable, effective, sustainable, and accessible to the poor. The most common methods employed by NGOs in delivering services to the extreme poor too often fall short.

We should remember that given the enormous population at the BOP, even with extreme poverty, it should be a significant consumer market for companies to sell their products to. However, according to “Reality Check at the Bottom of the Pyramid” by Erik Simanis (*Harvard Business Review*, <https://hbr.org/2012/06/reality-check-at-the-bottom-of-the-pyramid>), it is not because the “low price, low margin, high volume” requires “an impractical penetration rate of the target market — 30 percent or more of all consumers in an area.”

However according to the same report, “The model works well if two conditions are met: One, the company can leverage an existing infrastructure that serves wealthier customers to offer a product or service to poor consumers; and, two, the consumer already knows how to buy and use the offering.”



TIP

The goal of social franchising is to target an underserved population living in extreme poverty by increasing access to products and services that “consumers already know how to buy and use.”

The products and services currently offered through social franchising now are focused on safe drinking water, food, sanitation, healthcare, education, and clean energy — the products and services the consumer needs to survive. Ultimately, the products and services that become available through franchising will expand as the economic conditions in the markets improve, and will then include those the consumer may simply want.

Social franchising has the potential for solving the first hurdle identified by Erik Simanis — the lack of an existing infrastructure by effectively creating that

infrastructure through supported local ownership and management. In effectively addressing this concern, franchising's inherent advantage over other methods of downstream distribution used currently at the BOP is its ability to effectively develop, scale, and support a local infrastructure necessary to distribute the products and services at a lower cost at higher consumer standards, while also leveraging alternative methods of distribution. Franchising must always be viewed, whether in a commercial or social setting, as part of the mix of available methods of expansion and downstream distribution of products and services. Franchising works best for enterprises when it is viewed as an alternative method of distribution and not viewed as the sole method of distribution a company employs.

Social franchising provides opportunities for local franchisees that have limited access to capital and other resources and provides them with the support needed to create local businesses and succeed. Because of the methods and techniques used in commercial franchising, social franchising's business model is capable of low cost and rapid growth while at the same time maintaining consistent standards and achieving economies of scale. What social franchising is, is the use of the methodologies found in commercial franchising to scale businesses and solve both the economic and social problems for those that live at the Base of the Pyramid (BOP).

CFWshops: An Example of a Social Franchise System

Scott Hillstrom is the founder of Child and Family Wellness Shops (CFWshops for short), a medical clinic social franchise in East Africa. Scott was awarded the Entrepreneur of the Year Award by the International Franchise Association in 2014 for his work in developing social franchises. Scott is a lawyer by training and an entrepreneur through experience. His adoption of social franchising was not by chance but arose out of his curiosity of trying to understand why sustainable solutions were easily available in the commercial world but seemingly unworkable in the social sector.

How CFWshops got started

CFWshops, headquartered in Nairobi, Kenya, is a network of locally owned franchised medical clinics providing authentic drugs and quality medical care to people at the base of the pyramid. Since it was established in 2000, CFWshops in Kenya has served more than 5 million patients.

Scott had become frustrated with the inefficiencies, high costs, and low standards of NGOs in delivering medical services in the emerging markets. He was enamored by brands like McDonald's and Subway that could provide their customers, regardless of the market, the same quality French-fries and sandwiches and do so in a way that replicated the brand's culture and quality at each location. His vision was that if commercial franchising could accomplish that with food, he could do it with medicine and other services in Africa.

The barrier faced by CFWshops is that without a consumer base with the ready ability to pay for its products and services, and the lack of a workable social service net to pay for those services (think insurance, Medicare, and Medicaid in the United States), it was still highly reliant on third-party funding like any other NGO.

The CFWshops model incorporates the key elements of commercial franchising, including brand standards, selection of franchisees, training, support, marketing, critical mass, and (essential for the markets and consumers it serves) a supply chain that combines the buying power of the network to obtain necessary quality medicines at the lowest possible cost.

Under its current approach, CFWshops is now targeting the use of emerging forms of public social service nets coming online from the government and the emergence of social investing. It is modifying its delivery system that retains the ability of its consumers to have local access to basic services but has expanded its capacity to provide a broader service offering through hub clinics that serve a wider market. The hub clinics provide local consumers with access to treatments that are not as frequently needed at the local level, that require a higher capital investment and level of professional service provider than possible previously. This hub and spoke method is an adaptation of similar methods found in commercial franchising. As discussed shortly, the hub and spoke method is also being employed elsewhere.

CFWshops expanded further by using a master-franchising approach, similar to that used in commercial franchising in Rwanda. Under the leadership of Gunther Faber, former vice president, Sub-Saharan Africa for GlaxoSmithKline, CFW licensed One Family Health to use CFW's intellectual property for expansion into Rwanda. The combined system has more than 160 franchisee-owned-and-operated rural medical clinics today. As in a commercial franchise system, each franchisee invests in the development of their business (although the cost may be subsidized) and operates their businesses to the brand standards and with the support of the franchisor.

The CFW social franchise model is not a static one-size-fits-all model. As with commercial franchising, the model is an adaptive structure. In contrast to Kenya, in Rwanda One Family Health has been able to leverage the government's mutual health insurance program (similar to our Medicare) that enables consumers to pay for its products and services. As discussed earlier, in Kenya the model is evolving to include a hub-and-spoke model where both middle-income and low-income patients can be served, making it more attractive to social investors. The hub-and-spoke model allows for the more effective use of higher-cost technology at the "hubs" when required by patients, and allows for easy access by consumers through a network of supported local nurse-owned franchises at the "spokes" level.

Your co-author Michael Seid, together with several past chairs of the International Franchise Association (IFA), Sid Feltenstein, Jim Amos, Steve Greenbaum, and past board member Eric McCarthey, are members of the CFWshops board and are on the executive committees of the HealthStore Foundation, its parent. Michael Seid and Sid Feltenstein also serve on the board and executive committee of One Family Health, and Michael serves as chief concept officer for both brands.

Using the hub-and-spoke and other variations of commercial franchising

This hub-and-spoke model is nothing new, radical, or untested. It is an adaptation of methods long in use in commercial franchising to leverage human and economic resources while improving system performance. MSA and Julie McBride are currently working with the PharmAccess Foundation, a global leader in healthcare finance and delivery based in The Netherlands, to develop a hub-and-spoke social franchise model in combination with a master-franchise approach for the creation of a chain of birthing centers in Ghana.

Childbirth is something relatively safe in the industrial world but is one of the leading causes of death for woman at the BOP. At the BOP, the cost of the necessary equipment and facilities for quality prenatal care and safe birth is relatively high, and there is an increasing "brain drain" as qualified medical practitioners find opportunities to earn a living in outside of their home markets.

The goal of the Woman 360 birthing center system is to establish hub birthing centers, centrally located and owned by master franchisees, that will support local and easily accessible franchised spoke clinics owned and operated by midwives and other qualified medical persons. By providing routine and locally accessible quality prenatal services to woman and enabling those women to have access to a

higher level of medical care should it be needed during their pregnancies, Woman 360's goal is to improve the level of medical care for women in the communities it serves in Ghana.

Each hub-and-spoke system will enable women, through available transportation, to give birth in modern, well-staffed, and technologically advanced birthing hospitals. The social franchise structure is designed to reduce the overall cost for women to receive quality medical care throughout their pregnancies, starting with the care they can receive at supported locally owned centers. Leveraging modern IT systems, medical records can be shared between the local clinics and hub centers, and through telemedicine and other technology, medical issues that may routinely arise can be addressed by the doctors at the hub centers and effectively treated by the franchisee and their staff at the local level. Both the hub-and-spoke system will execute to common brand standards, including location design, décor, equipment, services, supply chain, medical standards, and business focus.

Similarly, enterprises like Population Services International (PSI), a large non-profit global health organization, use social franchising to support a variety of different social franchise brands internationally. In many markets, the PSI brands use an approach called *fractional* or *bolt-on* franchising, placing their branded medical services within existing medical facilities.

The use of fractional franchising is common in the United States and is an effective adaptation for use at the BOP.

Consider that it is common and convenient for medical services like those found in a CVS Pharmacy Minute Clinic or cosmetic counters found in department and specialty stores. These are well-accepted "bolt-on" commercial approaches. In social franchising, bolt-on franchises are being established in local pharmacies to diagnose and treat common problems like malaria in markets where qualified medical doctors are unavailable or unaffordable. Each pharmacy has franchisor-trained personnel, and each fractional franchisee is supported and held to the same quality standards as any other franchise. The difference between a bolt-on franchise and a franchise like CFW is that in a bolt-on franchise, the franchisor's brand is not used by the entire business and instead is limited to the products and services licensed by the franchisor.



REMEMBER

The adaptation of methods and practices found in commercial franchising are effectively and easily being used in the social sector.

Who Are the Franchisor and Franchisee in a Social Franchise?

There is a range of business structures used in social franchising. The franchisor may be structured as a nonprofit, for-profit, or other type of structure that is specifically designed for a social enterprise, such as one of the following:

- » Social purpose corporation
- » Low-profit limited liability company (L3C)
- » Benefit corporation
- » Cooperative
- » Hybrid

There are advantages and disadvantages to the nonprofit and for-profit approaches. The key advantages of structuring the franchisor as a for-profit entity are the following:

- » Incentives between franchisor and franchisee are better aligned, which drives performance at all levels of the system.
- » The franchise system is funded as it would be in a commercial franchise from continuing fees and supply chain revenue.
- » Donor funds can be used more efficiently to create direct subsidies for the poor through insurance and other programs so that more people can access products and services delivered by the franchise.
- » As a consumer offering, there is a greater incentive for the local franchisee to meet brand standards and consumer expectations.

The key advantages of structuring the franchisor as a non-profit are as follows:

- » The franchisor uses third-party grants and donations to cover its operating costs.
- » The franchisee is subsidized, reducing some of the profit pressure on the business.

If there is a disadvantage to the nonprofit approach, it's that the incentive for meeting brand standards and consumer needs is diminished to some extent, as the normal commercial pressures of consumers making independent choices about where they shop may also be diminished. That lack of consumer focus may introduce inverse opportunities for a lessening of brand standards. Also, because

social franchising relies to a great extent on donations, any restrictions on donor funding or requirements by donors looking to make changes to the underlying system to meet their unique views of how they want the products and services they want to support delivered can have a negative impact on the social system overall. This routine requirement, often factored into donor funding, can be extremely damaging within a social franchise structure.

Ideally, over time a social franchise will deliver both social and financial returns to stakeholders (often referred to as *double bottom line*). Financial results are critical to the mission because it is financial success at the unit level that drives expansion to more franchisees in additional markets. Through *scaling* (developing sufficient locations to service the market and create an economic base for the system), the additional locations will increase the overall social impact of the franchise system.

Social *franchisees*, like commercial franchisees, are local business owners who operate their franchised business at a profit. Although the social mission of the business may be important to them, because the business is generally their primary source of income, the social mission is usually secondary to their profit incentive. Therefore, in selecting social franchisees, in addition to all the other requirements found in the selection of commercial franchisees, the social franchisor must ensure that the franchisee understands and accepts the critical need of the social mission. It is because of the profit incentive that many social franchises are started — not to solve a social need, but because the franchisor saw the social need as a business opportunity.

Again, because of its adaptive nature, franchisees can be single-unit or multi-unit owner operators but can also include social investors seeking to own and operate multi-unit operators and who will employ the professional staff working within the local operations.

DISTRIBUTION MODELS IN SOCIAL FRANCHISING

There are multiple ways to apply commercial franchising to social franchising. Three common distribution models are distribution of products, fractional (bolt-on to an existing business), and business format franchising. Each method is used to achieve different outcomes and to maximize local opportunities, as each can be used at the same time depending on the needs and opportunities available to the franchise system. What differentiates the use of each are the intended stakeholder benefits, including the consumer, the franchisee, the franchisor, the donor, the grantor and investor, bankers and other financial institutions, and local governments.

Financing and Developmental Benchmarks for Social Franchises

Chapter 6 discusses funding for social franchisors. Social franchises use the following sources of capital to help them fulfill their missions:

- » Fees for goods and/or services
- » Individual donations and major gifts
- » Bequests
- » Corporate contributions
- » Foundation grants
- » Diaspora funding
- » Government grants and contracts
- » Debt and equity capital (usually via impact investors)
- » Interest from investments
- » Loans/program-related investments (PRIs)
- » Tax revenue and government grants
- » Membership dues and fees

Different and sometimes blended funding vehicles are used to support different growth drivers at each stage of a social franchise's development. It is critically important that each stage of development be adequately funded in order to achieve key performance benchmarks before progressing to the next stage. The general stages of funding and developmental benchmarks are discussed in the rest of this section.

Stage one: Developing and proving the concept

During stage one, the social business concept requires development level funding generally in the form of grants to develop the concept, its infrastructure, and working capital. The donor also provides or pays for technical assistance and provides subsidies for the consumer to purchase the products or services. Stage one is used to test the viability of the concept as a social business and refine the model until it is able to deliver desired social and financial results in one location.

The proving stage is where several locations are opened and operated to fine tune the concept and prove its economic performance and consumer acceptance. Development benchmarks for this stage include the following:

- » The concept is based on well-established consumer demand in a stable and growing industry.
- » The regulatory environment in the country doesn't impede operations.
- » The concept is well defined (brand personality, marketing, expenses, pricing, product sourcing, seasonality, location requirements, labor and training requirements, and so forth).
- » The concept is operational and is achieving earnings and impact goals.

Technical assistance required to achieve benchmarks includes developing the tactics.

Stage two: Proving the replicability of the concept

During this stage of development, the concept will be tested in additional locations and further fine-tuned to optimize performance and prove consumer acceptance and profitability in a variety of settings.

Development benchmarks include the following:

- » There is sufficient consumer demand in additional markets for the system's products and services.
- » The consumers or third-party payer is able/willing to purchase products or services.
- » The business can be replicated (the system can be transferred and operators can achieve brand standards consistently).
- » Last-mile quality supply chain can be sustained.
- » Potential qualified franchisees for the business are willing and able to afford initial investment.
- » Potential franchisees have access to capital needed to invest in the franchise.
- » Business can achieve economic benchmarks, including return on investment (ROI), ability to support debt service, acceptable breakeven point, and providing a living wage for owner operator.

- » The franchisor management team is committed and capable of supporting franchise system.

The following technical assistance is required to achieve those benchmarks:

- » Replicating the social enterprise in one or more additional markets
- » Adapting the business to new markets
- » Assessing the expansion readiness of the business after it has been operating in additional markets
- » Determining the best replication model for the business
- » Preparing the business for expansion through the selected replication model (for example, franchising)

Stage three: Developing the franchise system

During stage three, the social franchisor's concept and franchisor offering are designed, developed, and tested. Through mainly grants, but with some acceptable equity participation, the franchisor's support organization is designed and developed, and local franchisees are provided with the necessary development and working capital to open locations, prove and fine-tune the franchise system. Subsidies will generally be required for local consumers.

Development benchmarks for this stage include the following:

- » The critical elements of a successful franchise system are in place — franchisee recruitment, location selection and development, operations expertise, marketing, supply chain, legal, initial and continuing support, merchandising, compliance, research, and more.
- » Growth capital for franchisor and franchisees is available and committed.
- » Expansion plan is geographically developed to enable franchisor support.

The following technical assistance is required to achieve the benchmarks:

- » Designing the franchise system (creating the franchisor entity and the strategic plan for operating an effective and sustainable franchise).
- » Producing the franchise tactical elements (preparation needed to execute strategy: operations manuals, training programs, supply chain, marketing plans, legal documents, and so on).

Stage four: Expanding locally and nationally

Once the franchise system and support requirements have been developed, consumer acceptance has been validated, and financial sustainability of locations has been proven, debt and equity investment is used to expand the social franchise system on a local or national level, with donor funding generally targeted at consumer subsidies:

- » The brand is recognizable and drives customers to the business.
- » There is sustained and growing retail demand for franchisees.
- » ROI is attractive to investors and donors.
- » Social results are strong and attractive to donors.

The following types of technical assistance are required to achieve those benchmarks:

- » Recruiting, selecting, developing, and supporting master franchisees nationally
- » Evaluating the system performance nationally
- » Refining the system to improve performance nationally

Stage five: Expanding globally

Once the franchise system has expanded locally and nationally and the franchisor has gained the necessary experience required as a franchisor, the social franchise is now ready for a more global approach to expansion. As with stage three, a blend of debt, equity, and grant capital is used to support growth.

Development benchmarks for this stage include the following:

- » The franchise system is meeting its national impact and financial goals.
- » The brand has achieved national recognition.
- » Global expansion opportunities have been evaluated, and analysis reveals opportunities for products and services in additional global markets.
- » Funding is available to expand to new global markets.
- » The number of franchisees is growing.

- » The support system including supply chain can be replicated in the additional targeted markets.
- » There are available potential franchisees in the targeted markets.
- » The system can be changed and supported based on local consumer requirements.

The following technical assistance is required to achieve benchmarks:

- » Adapting the franchise business to new global markets
- » Executing the franchise sales plan globally
- » Executing the franchise training program globally
- » Recruiting, selecting, developing, and supporting master franchisees globally
- » Evaluating the system performance globally
- » Refining the system to improve performance globally

Delivering on the Brand Promise

In any franchise system, including social franchise systems, a rigorous compliance system is required to maintain control over the delivery of the brand promise to consumers. Ensuring that franchisees have the necessary tools for local success requires that the franchisor provide them with the needed initial and continuing support, as found in commercial franchising. By tying the franchisee's continuing license to unit performance metrics and financial sustainability, the value of the franchise deters them from behaving in ways that would risk losing franchise rights.

Every variation of commercial franchising can be applied to social franchising. Along with its clients, MSA Worldwide has developed social franchise systems using single-unit and multi-unit franchising. What social and commercial franchising have in common is that they offer franchisees a brand and consumer products and services that represent a value to consumer in products and services they not only want but that they need.

Methods like fractional or bolt-on franchising leverage established infrastructure by bolting-on the franchise system's consumer offering to established businesses serving the consumer, whereas master franchising allows economic investors or strategic franchisees to support a local network of franchising, reducing the

economic burden on the franchisor. Master and multi-unit development franchising, using a hub-and-spoke approach, also allows medical franchise systems to better utilize capital intensive equipment and deal with the professional brain drain that impacts many BOP markets. Regardless of the commercial franchising approach adapted for the social franchise, the franchisee makes an investment in developing their business, identical to commercial franchising, with the possible exception of a portion of their investment needing subsidization by the franchisor or donor.



REMEMBER

Initial and continuing support, including providing a beneficial supply chain, support, and training are identical to those provided in commercial franchises.

Resources for Social Franchising

Many of the resources available to traditional NGOs are also available to social franchise systems. This section talks about a few of them.

Government funding agencies for global development

Following are the top government agencies involved in providing global aid, grants, and assistance. On each country/agency site will be information on the type of organization, development budget, focus on target countries, contact information, and more:

- » Agence Francaise de Developpement (www.afd.fr/home)
- » Australian Agency for International Development (www.internationalneeds.org.au)
- » Austrian Development Agency (www.entwicklung.at/en/)
- » Belgium Foreign Affairs, Foreign Trade and Development Cooperation (<http://diplomatie.belgium.be/en>)
- » Canadian International Development Agency (www.international.gc.ca/development-developpement/index.aspx?lang=eng)
- » Danish Ministry of Foreign Affairs (<http://um.dk/en>)
- » Dutch Ministry of Foreign Affairs (www.government.nl/topics/development-cooperation)

- »» Finnish Ministry for Foreign Affairs (<http://formin.finland.fi/public/default.aspx?culture=en-US&contentlan=2>)
- »» Gesellschaft für Internationale Zusammenarbeit (www.giz.de/de/html/index.html)
- »» Greek Ministry of Foreign Affairs (www.mfa.gr/en/)
- »» Irish Department of Foreign Affairs/Irish Aid (www.irishaid.ie/)
- »» Italian Ministry of Foreign Affairs' Directorate General for Development Cooperation (www.esteri.it/mae/en/ministero/struttura/dgcoopsviluppo/)
- »» Japan International Cooperation Agency (www.jica.go.jp/english/)
- »» Korea International Cooperation Agency (www.koica.go.kr/english/main.html)
- »» Kreditanstalt für Wiederaufbau (www.kfw.de/kfw.de-2.html)
- »» Luxembourg Ministry of Foreign Affairs (www.gouvernement.lu/maee)
- »» Millennium Challenge Corporation (www.mcc.gov)
- »» New Zealand Aid Program (www.mfat.govt.nz/en/aid-and-development/)
- »» Norwegian Ministry of Foreign Affairs (www.regjeringen.no/en/dep/ud/id833/)
- »» Portuguese Institute for Development Support (www.anacom.pt/render.jsp?contentId=84460)
- »» Spanish Ministry of Foreign Affairs and Cooperation (www.exteriores.gob.es/Portal/en/Paginas/inicio.aspx)
- »» Swedish International Development Cooperation Agency (www.sida.se/English/)
- »» Swiss Agency for Development and Cooperation (www.eda.admin.ch/sdc)
- »» U.K. Department for International Development (www.gov.uk/government/organisations/department-for-international-development)
- »» U.S. Agency for International Development (www.usaid.gov)

Private philanthropic foundations

Private foundations are playing an increasingly important role in funding international development, especially when bilateral and multilateral donor funds are restricted or restricting. Private foundations often support social enterprise development and may be interested in supporting the expansion of some of the social

businesses in their portfolio through a franchise model. Following is a list that Devex (an international development news agency) compiled of the top ten private foundations according to their global development contributions. The Devex website (www.devex.com/news/top-10-philanthropic-foundations-a-primer-75508) provides more information about each of the foundations and their total global development giving.

- » Bill & Melinda Gates Foundation
- » Open Society Foundations
- » Ford Foundation
- » William and Flora Hewlett Foundation
- » Children's Investment Fund Foundation
- » United Nations Foundation
- » John D. and Catherine T. MacArthur Foundation
- » Conrad N. Hilton Foundation
- » Rockefeller Foundation
- » Gordon and Betty Moore Foundation

Corporate philanthropists

Corporate philanthropy has been essential to the delivery of products and services to consumers at the base of the pyramid. Through grants and the access to significant human and other resources, corporate philanthropy has played an essential part of providing the necessary resources. According to a survey of Fortune 500 companies (<http://fortune.com/2016/06/22/fortune-500-most-charitable-companies/>), the top 20 most generous companies donated \$3.5 billion in cash in 2015. Those companies are as follows:

- » Gilead Sciences
- » Walmart
- » Wells Fargo
- » Goldman Sachs Group
- » ExxonMobil
- » Chevron
- » JPMorgan Chase

- » Bank of America
- » Alphabet (Google)
- » Citigroup
- » Microsoft
- » Merck
- » Coca-Cola
- » AT&T
- » Target
- » General Mills
- » Pfizer
- » Kroger
- » PNC Financial Services
- » Morgan Stanley

Impact investors

Impact investing seeks investments that have the potential to make a significant and positively impact on society. Impact investments are made in organizations that seek to generate measurable social benefit as well as a financial return. Investors in this space are typically interested in businesses that address social issues such as health, education, poverty reduction, and environment. According to Investopedia (www.investopedia.com/articles/active-trading/090115/top-5-impact-investing-firms.asp), the top five impact investors, based on assets under management, are as follows:

- » Vital Capital Fund
- » Triodos Investment Management
- » The Reinvestment Fund
- » BlueOrchard Finances, S.A.
- » Community Reinvestment Fund, USA

THE IFA SOCIAL SECTOR FRANCHISING TASK FORCE

Several years ago, the International Franchise Association (“IFA”) established a Social Sector Franchising Task Force as a platform to advance and leverage the use of commercial franchising methods and technology in social franchising. Founded and continually chaired by Michael Seid, a member of the IFA’s board of directors, the task force was established to share best practices and lessons between commercial and social franchising professionals.

The IFA’s task force is composed of some of the leading franchisors, franchisees, and professionals in commercial franchising and has attracted a number of social franchisors and their advisors into its membership. In addition to sharing of best practices, the members of the task force also provide mentoring and coaching to NGOs and social franchisors. Managed by Marla Rosner, senior learning and development consultant for MSA, the task force has developed a toolkit for social franchisors and NGOs to facilitate high-quality social franchise system design and execution. The template also provides information on the legal issues that need to be addressed in the development of social franchise legal agreements. You can find it at www.socialsectorfranchising.org.

6

The Part of Tens

IN THIS PART . . .

Discover the ten keys to success as a franchisee.

See if you have what it takes to become a franchisor.

Check out our helpful and handy glossary of the most-used franchising terms.

IN THIS CHAPTER

- » Having enough money, discipline, and personal support
- » Recruiting, retaining, and training your employees
- » Serving your customers, community, and franchise

Chapter **18**

Ten Keys to Franchisee Success

It isn't easy to achieve success in any business. After all, it takes talent to make certain that your customers are always satisfied. If you have selected a great franchise system, your franchisor has given you the tools — but it left it up to you to get the job done. How you manage your business is critical. We have emphasized that fact throughout this book: If you don't do it, no one is going to do it for you.

In this chapter, we offer you our list of the top things that may help your franchise experience be a success and (we hope) help you stay in front of the pack.

Make Sure You Have Enough Money

Do a personal assessment and make a plan. How much do you have to invest, how much are you willing to risk, and how much will you need to live on for at least the first 12 months that your new business is open?

Remember, you and your family have to live, and being able to have fun is something you should budget for. Emergencies, unfortunately, are also going to

happen. Carefully review your personal finances with professionals so you know what you can afford to do.

Follow the System

You're paying to join a system — follow it.



WARNING

If you don't think you'll be able to follow the system and believe you'll be able to tinker with it by changing or adding products, modifying the advertising, and customizing the services, hours, and even quality and consistency standards prescribed by the franchisor — don't make any franchise investment. If you need to be an entrepreneur and can't be a formula entrepreneur, then franchising is likely not for you.

By following the franchisor's system, you preserve the brand and protect your investment and those of your fellow franchisees, because you're giving consumers what they expect.

Don't Neglect Your Loved Ones

Running any business is hard work, and it can consume a lot of what used to be your family time. You're on occasion going to be under pressure — some self-imposed and some imposed on you by your customers and your franchisor. You're going to experience the natural fear of failure on occasion, and if you're not prepared for that roller coaster, be aware that it can have an impact on your personal life. Be prepared.



TIP

You're going to need the support and understanding of your loved ones, especially when the pressure is on. Don't forget that they will share in your sacrifices too. Plan on setting aside time for just you and the important people in your life. If the only time you have for your kids is a quick bite with them at night, make sure that time is about them and not about your business. When they grow older and maybe join you in your work, there will be plenty of time to talk about business.

Be Enthusiastic

Your success is going to be linked to the level of enthusiasm you bring to your work. Show that enthusiasm to your management team and staff because enthusiasm is contagious. When you show a positive attitude to your relationship with your staff, it brings a level of excitement and energy to the entire operation that everyone, including your customers, will feel.

No matter how you feel, no matter what the problem is, no matter who you're mad at, when you come to work, be enthusiastic and upbeat. You may be trying to fool only your staff and your customers, but if you keep it up long enough, you may even fool yourself.

Recruit the Best Talent and Treat Them with Respect

Having a great staff is essential, and attracting and retaining the best people is the key to success. Your job is to motivate them, train them, support them, reward them, and, when necessary, discipline them. Although your franchisor can train you on what to look for, only you can set your human resource policies and only you can manage your team.



TIP

Often paying more is the cheapest investment you can make when looking to recruit and retain the right people — especially when those people are going to make you successful.

We sometimes overlook workers that are more seasoned — those whose first career has ended and who still want to contribute and work. Seek out the senior citizens in your neighborhood. They generally are skilled, have a wonderful work ethic, and often can be role models for younger employees.

Seek out the physically and mentally challenged and find a place for them on your team. We're not suggesting this as a "feel good" program. Some companies perceive problems in making needed accommodations, but in our experience those that do reach out to work with the physically and mentally challenged find it strengthens their business.

Ensure that your entire staff knows their jobs and are cross-trained when possible. Also, take care to communicate the terms of their employment, including pay structure, hours, benefits, holidays, and vacation policies. When possible, make work schedules available well in advance so that your employees can plan their personal lives.

Train Your Employees

You're going to be investing in the best people possible, so make sure you train them well for their jobs. There's simply nothing as frustrating to employees than being thrown into a job they don't know how to do. The happiest employees are the ones who get proper training so that they can do a good job.

Training should be continuous because your staff is your front line, constantly meeting and greeting your customers. They are the ones you will be relying on to grow your business. Poorly trained staff will lead to dissatisfied customers.

Although your franchisor may give you training tools, it's your responsibility to train your own employees. Providing your team with training is a good way to show your employees that they matter to you.

Give Customers Great Service

You invested in your franchise because it had a system to provide consistent products and services to consumers. In fact, even if you didn't have a contractual obligation to follow your franchisor's system and meet each of its brand standards, it still would be essential that you did. Respect your brand and make sure your staff is well groomed. Clean the bathrooms and treat your customers as if they are guests in your house.

In great franchise systems, the franchisor has established brand standards and provides its franchisees with the support needed to deliver its products and services consistently, regardless of location. This consistency is what customers expect and why they were attracted to your business in the first place. But more than delivering consistently, if you truly want to be successful, provide great service to your customers.

Get Involved with the Community

You should be as interested and involved in your community as a baby-kissing politician. Being part of the fabric of your community is essential because customers like to shop with their neighbors and especially at businesses that support them. We're not talking about advertising — this is where marketing becomes

important. See what your franchisor recommends and what has worked for other franchisees. You might consider doing the following:

- » Sponsor a Little League team, participate in civic organizations, and conduct tours of your business for school groups.
- » Start a nursing-home visitation program, set aside a day to give a portion of your proceeds to charity, set up a kiosk at community events (if your franchisor allows), and get together with other franchisees in the market and sponsor an event together.
- » Provide students who are getting good grades a discount or free products when they bring in their report cards.
- » Join and support your Better Business Bureau, Chamber of Commerce, Rotary Club, or other local community-based organizations.

Stay in Touch with Your Franchisor and Fellow Franchisees

Most franchisors invest heavily in communications about new product development, troubleshooting tips, employee relations, upcoming meetings and conventions, franchisee achievements, and other important news.

How they communicate is not that important, but you should seek opportunities to participate. Participate in each of the face-to-face opportunities, including training programs, field visits, conferences, and conventions. Take advantage of every opportunity to exchange information with your franchisor.

The International Franchise Association (IFA) holds local monthly meetings where you can network with franchisees and franchisors from other systems and get to know local franchise suppliers. These are great opportunities to learn what others that may not be involved in your franchise system are doing. You might even consider getting involved in your local Franchise Action Network (FAN). FAN is a grassroots effort to protect franchising from proposed laws that might negatively impact your business. Check out www.franchise.org and find out if FAN has a grassroots meeting in your community.

Pay Attention to the Details

Success is in the pennies. To run a successful business, you must minimize costs and maximize sales. Minimizing costs goes beyond cutting the best deal for your raw materials or inventory. Minimizing costs means you have to be diligent and carefully observe how your business operates day-to-day:

- » Watch out for your *shrinkage*, the merchandise that goes missing and unaccounted for due to employee theft, customer theft, vendor theft, or maybe simple bad management, inventory, and ordering procedures. Every time products disappear, are damaged, or are prepared but not sold, that's money out of your pocket.
- » When you see a vendor improperly handling your delivery, bring it up immediately. The same thing goes for employees who aren't handling products correctly.
- » Plan your labor. Look at any business: Some days are busier than others, and some hours during the day are busier than others. Learn how to schedule to meet your needs.
- » Work hard every day. Some days you may want to kick back just a little and coast, putting the business out of your mind for a while. We're not recommending that you deprive yourself of breaks from the business, just that you choose your time away from the franchise wisely.

- » Conducting a self-interview to determine whether franchising is right for you
- » Knowing the factors that should help you decide whether to take the plunge

Chapter **19**

Ten Questions to Ask before Becoming a Franchisor

Making the decision to become a franchisor can be exciting. But are you sure now is the right time to make that leap? As we've reminded you throughout, other than needing a franchise disclosure document and, in certain states, sending it in for review by a state regulator, literally anything can be franchised in the United States. If you're considering franchising your business, you should have a proper threshold analysis conducted by a qualified franchise consulting firm.

Franchising is all about consistent, sustainable replication. If the franchise system you put together can't generate sufficient revenue for both franchisor and franchisee — if you can't recruit a sufficient number of franchisees from the classes you need, and if you can't achieve economies of scale — then your franchise system isn't going to last long.



WARNING

Be wary of franchise-packaging firms and brokers waiting to tell you, no matter what your concept is and even if your business has never made a profit, that you're going to be the next McDonald's or Firehouse Subs or Marriott Hotel. Packagers prey on emotions.

This chapter offers ten questions that we expect you need to answer and will keep moving you in the right direction as you consider becoming a franchisor. Take a look at Chapter 14 for more questions you should also consider.

How Good Is Your Product/Service?

Is your business based on either well-established consumer demand or a trend that will keep the company's products and services in demand for the foreseeable future? Is the market for your product or service growing? What is the competitive environment for consumers that you think will be beneficial to your long-term success? Will technology have a positive or negative impact on your business?

Does your business have the necessary economics to be a franchise? Remember, in addition to the costs of operating the business, franchisees will incur initial and continuing franchise fees. After imposing franchise fees, is your business sufficiently profitable to break even in a reasonable period of time? Will the franchisee be able to service their debts? Will the business generate enough income to pay the franchisee a salary? Will it earn an acceptable return on investment for the class of franchisee you're targeting?

Can You Manage the System?

You view yourself as self-reliant and responsible, and that's great. Some of the most successful new franchisors we know have enthusiasm and understand what it takes to succeed. That's one reason why their franchise systems are great opportunities for new franchisees. But do you have the experience necessary to manage a growing chain? Do you have a clear history of financial and personal accomplishments?

You won't be able to run your franchise system by yourself for very long. Are you willing and able to afford to recruit the management and staff to fill any gaps in the skills that you will require? Remember, you'll need the capability to add sustainable value to the franchise relationship, including new product and service enhancement, management and staff training, operations manuals, field consulting, consumer and franchisee marketing capabilities, multi-unit operations skills, and other support services required by a growing franchise system. Are you able to do that?

Do You Have the Commitment?

Once you become a franchisor and have recruited franchisees, changing your mind isn't really an option. You've signed a contract with franchisees, and both you and your franchisees have obligations to each other.

You need to be committed for the long haul and be able to make the required financial investment — not just to develop the franchise system and recruit franchisees, but to support them and ensure they can deliver consistently on your brand promise to consumers.

You will also need the resources to change and adapt your system based on the competition, technology, and local market conditions. Evolving your products and services and continually motivating your franchisees to achieve success aren't easy, and for some they don't come naturally. You need to be committed to becoming a great franchisor — even before you begin developing your plan for franchising.

Can You Systemize Your Business?

Every successful franchise needs to be based on a set of refined and unified operating processes that have been tested and proven in actual operating locations. Clearly define and document the systems franchisees will need to operate their businesses so they have the tools to meet your brand standards.

Can you communicate to franchisees and their staff your system standards and procedures in well-documented operations manuals? Do you have forms and checklists to keep your franchisees on track? Have you considered what parts of your manual library you need to develop first and what can come later as you grow? Remember, having a manual to simply operate the location won't be enough. Before your franchisee opens the door to any customer, they should have a manual that tells them how to locate the right venue and develop it to your standards.

Can You Train Your Franchisees?

You're not going to be with your franchisees on a day-to-day basis. They are independent business people who are responsible for managing their businesses and supervising their staff. Although you may have a system for delivering products and services to consumers, whether a franchisee succeeds or fails will largely be based on their own efforts and competence.

You need to have a training program that can teach franchisees and their staff what they need to learn. You're going to commit in your franchise agreement to conduct that training over a precise time period. Many franchisors, when setting out the time commitment in their franchise agreement, look at other franchisors and base the length of training on what others are doing. However, the length and content of your training program needs to be what you believe is required for your franchisees to have the tools to operate to your brand standards.

You also need to think about what happens after the franchisee opens the door. Initial training generally won't be sufficient. Do your franchisees have the tools and capabilities to train their initial and replacement staff? Did you withhold elements from your initial training because the franchisee lacked sufficient experience to be able to absorb that level of nuance? Training is a continual feature in great franchise systems, and you need to plan from the start what that training will require and how you will deliver it.

Can You Localize if Needed?

Consistency is the hallmark of franchising. Consumers expect every location to operate at the same level of performance and they want the products and services to be consistent regardless of where they shop. But *consistent* doesn't necessarily mean *identical*. Are there variations that may be required because of real estate or demographics or changes in culture from one market to another? If so, are you willing to adapt your consumer offering to meet the desires of your customers? If not, you're in for a difficult time. Your products and services need to adapt to local market conditions (neighborhood culture, real estate, consumer preferences, local regulations, and so forth).

Are your products and services marketable against the competition? Are there competitive advantages or points of differentiation that make your products and services more attractive to consumers than what they can get elsewhere? Do you have a way to showcase those differences to attract customers?

Do You Have the Necessary Capital?

It's not enough to have enough money to design and develop your franchise system. Just being able to pay for the necessary consulting and legal services is insufficient. You need enough capital to get you through the initial launch period and sustain things until your franchise fees and royalties kick in.

One of the tricks franchise packagers use to attract clients is to tell prospective franchisors that they'll be able to recoup the packaging fees out of the first few franchises the franchisor sells. It almost makes sense — sell three franchises at \$35,000, and you're going to recover enough to pay the packager \$100,000. Sounds like a winning argument.

The problem is, having a disclosure document and manual only got you to the starting gate. Now you need to pay for recruiting franchisees. Then you need the necessary resources to meet your obligations as a franchisor. The fact is that your initial franchisee fee in the early days will likely barely cover the cost of recruiting a franchisee and getting them open — and it won't even do that if you had to split your initial fee with a broker. And consider that if it takes the franchisee six months or longer to get their location up and running, your royalties won't start coming in until they accomplish that important step. You need to be adequately capitalized from the start.

Are Enough Franchisees Out There?

You may only need an FDD to legally become a franchisor, but you're going to need franchisees to really become a franchisor. Unfortunately, it's not that uncommon for a company to have an FDD and then find out no one wants what it's selling.

You need to determine in advance — and this is one reason you need to have a professional threshold analysis conducted — whether there is an adequate pool of potential franchisees, in the classes you need, who are ready, willing, and able to become franchisees in your system. Understanding who you will be competing against for franchisees is essential. Don't fall into the trap of thinking you'll only be competing with companies that sell to consumers the same products and services you offer. Your competition for franchisees will come from a much greater universe, and you need to see how well that universe of franchisors is growing.

You need to at least be able to achieve critical mass and sufficient market share in the core markets you plan to target. Are those goals realistic and achievable? Do you have enough resources to properly put together a franchise-recruitment strategy and sustain your marketing until you've built up a solid pipeline of franchisees? Is there sufficient acceptable real estate available in the targeted markets to support your franchise system's growth requirements?

Do You Understand Franchising?

It's not enough to be able to work the grill or change a muffler. That's your franchisee's job. *Your* job is going to be operating and expanding a franchise system and providing support to franchisees. To make sure you have the necessary values, skills, and foresight, answer these questions:

- » Do you have adequate staff, resources, and trained personnel to meet your commitment to your franchisees?
- » Do you have the appropriate temperament and management skills to successfully manage and operate a franchise system?
- » Are you committed to regularly attending seminars on franchising and franchise system management to keep abreast of the latest techniques used in franchising?
- » Will you be active in your industry's trade associations (for example, National Retail Federation or National Restaurant Association)? Will you be active in the International Franchise Association (IFA), the trade association for franchising?
- » Will you and your management team study and become Certified Franchise Executives?
- » How many company-owned locations have you opened in the last two years? How many have you closed, and why?
- » Are your same-store sales increasing?
- » Are you innovative and can you create a culture of compliance with your future franchisees?
- » Will you welcome new ideas and innovations from franchisees to improve the franchise system's performance?
- » Can you or your general managers act as consultants and advisors to your franchisees?

Are You Willing to Hire Proper Franchise Professionals?

When franchise systems don't grow as expected or outright fail, it's not just the franchisor that suffers. If franchisees have invested in their businesses, they will suffer as well. Becoming a successful franchisor is hard. It takes commitment, talent, and capital.

It becomes far harder to succeed if the professionals you work with don't have the skills or commitment to give you the advice and support you require. If you're considering working with a broker or a franchise packager to design, develop, and market your franchise opportunity — or if you're thinking of saving some money and having a lawyer complete some fill-in-the-blank boilerplate documents for you — we recommend you go back and read this book again. If you come to the same conclusion after your second reading, our best advice to you is not to franchise. Spend some more time, become better educated, take some online courses, speak to some well-known and established franchisors, and reach out to qualified professionals before you take the next step.



REMEMBER

Working with competent, experienced franchise consultants and legal advisors is not an option — it's essential if you want a successful franchise system.

Glossary of Common Franchising Terms

Don't look for the following definitions in any legal journal. We want to give you a sense of what people in franchising mean when they say something — not turn you into a franchise attorney.

acknowledgment of receipt: Item 23 of the Franchise Disclosure Document (FDD) that is signed by the prospective franchisee and provided to the franchisor (in hard copy or electronically signed) as proof of the date the FDD was received by the prospect.

advertising fee: Franchise systems advertise to consumers — a lot — and most of the cost of developing the consumer marketing material is paid for out of a fund. Depending on the system, the fund also may pay for the cost of placing the ads you see on TV and hear on radio or elsewhere. The money to produce and place the ads gets there when the franchisee makes a contribution to the fund. That's what we call the advertising fee.

advertising fund: See *system brand fund*.

agent: A party that has implied or expressed (oral or written) authority to act on behalf of another.

approved advertising materials: Materials provided by a franchisor for the franchisee's use in his local market. These may also be materials created by the franchisee that the franchisor has approved for use.

approved site: A location that the franchisor determines meets its criteria for a location. Site approval does not usually indicate any level of sales or guarantee of the success of the location.

arbitration: A method of resolving disputes.

area franchisee (multi-unit): If you want to open and operate many locations and are willing to make the commitment to a franchisor that you'll develop an agreed-upon number of locations during a defined period — and in a defined territory — you're an area franchisee. You usually pay an area fee for the rights granted by the franchisor.

authorized or designated supplier: A supplier of products and/or services who has been approved by the franchisor to sell to franchisees. An approved supplier may be the franchisor or an affiliate company.

broker: An outside salesperson or firm. For a fee — usually a commission — brokers sell franchises for a franchisor. Some brokers like to call themselves franchise consultants but that's a misnomer (see *franchise consultant*, later in this glossary).

business-format franchising (BFF): Wendy's, Meineke, and PostNet are business-format franchisors. In a business-format franchise, the most important thing you get from the franchisor is the method to conduct the business. See also *product and trade name franchising* to understand how BFF differs.

business plan: A planning document that details the objectives for the business and established processes and the measures for meeting those objectives.

capital required: The initial investment or required amount of investment necessary to conduct the business.

certification: Program by which a franchisor or franchisee tests and attests to the ability of a manager or employee to perform certain job functions within the franchisor's standards. The franchisor or franchisee can usually revoke certification if the manager or employee fails to maintain standards in performing the job function.

churning: Sometimes franchises fail, and the franchisor becomes the owner of the failed location. In the hands of a non-franchisor, who does not have the ability to franchise the location to another person, the location may be a candidate for closure, if the non-franchisor didn't think that the location could be turned around. In the hands of some franchisors, though, that location, even with the prospect of continuing failure, is resold, sometimes again and again to new franchisees, who also eventually fail. Churning is not a common practice in franchising, but it does happen. Beware of franchisors that churn.

company-owned location: The locations owned and operated by a franchisor or affiliate. They should be identical in appearance and operations to those locations operated by the franchisees.

continuous training: In most franchise systems, you, your managers, and maybe your staff receive initial training when you join the system. In a good franchise system, the training is continuous, meaning that the franchisor offers you training throughout the term of the franchise relationship.

conversion franchisee: An independent businessperson who agrees to convert her business to the franchisor's brand and operating procedures. She changes the business name, adopts the franchise system's methods of operation, and agrees to pay fees.

copyright: The franchisor's ownership rights over the manuals and other published materials you use in the system.

culture of compliance: The franchisor's culture whereby franchisees and staff do what is right for the system based on a feeling or knowledge that it's the right thing to do within the company philosophy rather than because it's in the agreement or someone is watching.

customer information: Any information gathered by or for the franchisor or its franchisees about an actual or potential customer, including, without limitation, names, addresses, e-mail addresses, telephone numbers, and all other personally identifying information, regardless of whether such information was gathered prior to the commencement of the agreement; customer credit information; billing information; and records. Customer information is usually considered confidential information of the franchisor.

days: Generally refers to calendar days.

day-to-day management: As an independent owner, the franchisee is obligated to manage the day-to-day affairs of his business to meet the franchisor's brand standards.

default: Generally refers to the failure of either the franchisor or the franchisee to meet their obligations under the franchise agreement.

design: Includes everything that makes a location look like all the other franchise locations — the layout, colors, signage, logo, and so on.

disclosure document: Also known in the United States as the Franchise Disclosure Document (FDD). In the United States, all franchisees must receive an FDD at least 14 days before they sign an agreement with the franchisor or write the franchisor a check. Disclosure documents are not required everywhere around the world. In the disclosure document, you find information about the franchisor, including the obligations of the franchisor and the franchise, fees, start-up costs, and other required information about the franchise system.

distributorships: The right granted by manufacturers or wholesalers to individuals or businesses to sell their products.

financial performance representation: Generally refers to the Item 19 disclosure made by franchisors in their FDD and unit performance.

exclusive territory: If a franchisor agrees to give you an area around your location where it will not put another franchise or company-owned location, you have an exclusive territory. The area can be quite small (the four walls of your store) or it can be quite large (cities, counties, states, or countries). Most often, the size is somewhere in the middle.

FDD: Franchise Disclosure Document. See *disclosure document*.

feasibility study: A study of a company that is thinking about becoming a franchisor. The company usually hires a franchise-consulting firm that looks at the company and gives management its opinion on whether the company can become a successful franchisor.

Federal Trade Commission (FTC): The agency of the U.S. government that regulates franchising.

field consultant: Field consultants usually work for a franchisor. Their job is to make sure that the franchisees are following the franchisor's rules. In good systems, field consultants are also responsible for giving the franchisees advice and assistance in running their businesses.

footprint: The layout of a location, including placement of all furniture, fixtures, and equipment.

franchise: Every franchise is a license, but not every license is a franchise. Confused? Many people are. A franchise is a special type of license that usually has three elements: (1) The franchisor lets the franchisee use the franchisor's name and marks, (2) the franchisor provides the franchisee with assistance or has some control over how the franchisee operates the business, and (3) the franchisee pays the franchisor some money. In the United States, the fee is \$500 or more during a six-month period.

franchise agreement: The written contract between the franchisor and franchisee. The franchise agreement tells each party what it's supposed to do and what it isn't supposed to do.

franchise attorney: An attorney who specializes in franchise law.

franchise consultant: A business advisor with significant knowledge of the design, development, and operation of franchising and the underlying franchise relationship. Some brokers like to call themselves franchise consultants, but that's a misnomer (see *broker*, earlier in this glossary).

franchise fee: When a franchisee signs a franchise agreement, he usually writes a check to the franchisor — that's the franchise fee. The fee is the cost of joining the system. The fee is typically a flat fee, as opposed to a percentage of sales like the royalty.

franchisee: The person or company that gets the right from the franchisor to do business under the franchisor's trademark and trade name.

franchisee in good standing: A franchisee who is operating her business in full compliance with the franchisor's operating and other standards per the franchise agreement and is current with all payments due to the franchisor.

franchising: A method of distribution; in other words, a method of growing a business.

franchisor: The person or company that grants the franchisee the right to do business under their trademarks or service marks.

gray marketing: When a franchisee sells or uses products or services obtained through his franchise relationship in another business or sells products or merchandise to another company without the authorization of the franchisor.

gross sales: Generally the total sales of the business, before the collection of any sales taxes and after specified deductions. Generally used as the basis for percentage royalty calculations.

initial investment: The initial costs of getting into business, which usually include the franchise fee, the cost of the fixed assets, leasehold improvements, inventory, deposits, other fees and costs, and the working capital required during the start-up period.

inquiry: Anyone requesting information about a franchise opportunity, whether via the Web site, by telephone, by fax, and so on.

International Franchise Association (IFA): The industry trade association that represents franchising.

Internet sales: Any sale initiated and completed on the World Wide Web.

key supplier or vendor: A supplier with whom the franchisor has negotiated pricing or product availability and whose products or services are an integral part of the franchise system.

lead: An inquiry who is pre-qualified after the initial interview with a member of the development staff as meeting the minimum criteria to become a franchisee and is invited to submit a franchise application.

location: The site of the franchised or company-owned operation.

manual: The bible of a franchise system. The manual is the place to look for instructions on how the franchisor wants the locations to operate and for other policies and recommendations concerning the system.

market introduction program: Marketing, advertising, and public relations activities used to launch a franchisee's business. Also known as *grand-opening marketing*.

master franchisee: Take a look at the definition of *area franchisee*. Now, in addition to operating its own locations, the master franchisee also gets the right to sell franchises to subfranchisees within the master franchisee's specified territory. The master franchisee will have their own FDD and may provide to the subfranchisee some of the services provided by the franchisor and will typically split with the franchisor the franchise fee and royalties paid by the subfranchisee.

multi-unit franchisee: A franchisee who owns more than one franchise but may not have an area development agreement.

operating principal: Franchises owned by more than one person that appoint a single individual authorized to make decisions on behalf of the franchisee. This person is the operating principal and is usually the person with whom the franchisor consults regarding the operation and conduct of the franchise.

product and trade name franchising: Pepsi and Ford are product and trade name franchisors technically called traditional franchisors. In a traditional franchise, the franchisee sells or distributes a specific product using the franchisor's trademark, trade name, and logo (for example, automobile dealerships, truck dealerships, farm equipment, mobile homes, gasoline service stations, automobile accessories, soda, beer, and bottling), and the product generally needs pre or post sales service. The most important thing you get from the franchisor is the product that the franchisor manufactures, not the system of running the business, as in business-format franchising.

prospect: A person who has expressed interest in continuing the approval process by completing and submitting the franchise application and whose application has been preliminarily approved by the approval committee or the development director.

protected territory: Provides certain rights to franchisees within a market area but generally does not prohibit a franchisor from opening additional company or franchisee owned locations near a franchisee.

quality standards: Some systems have high quality standards; others don't. If franchisors want to control quality, however, they tell the franchisees what those standards are in their training programs, manuals, and other communications. Quality franchise systems tightly control these standards for the benefit of the franchise system and its franchisees.

registration: Some states in the U.S. require the franchisor to send the state its disclosure document for approval prior to offering franchises. No registration is required at the federal level.

registration states: The various states that require franchisors to submit their FDD for approval prior to offering franchises.

retrofranchising or refranchising: Retrofranchising and refranchising are not the same as churning. These are existing locations that may or may not have ever been franchised before but are currently operated by the franchisor. The franchisor that is retrofranchising or refranchising locations is selling the operating business to a franchisee. In these situations, the franchisor has an expectation that the business will be successful. See also *churning*.

royalty fee: The franchisee sends the franchisor a check on a regular basis to stay part of the franchise system. Usually, the payment is based on a percentage of the franchisee's gross sales, but it can be a fixed fee or calculated on some other basis. That continuing fee is the royalty fee.

service mark: A mark used to identify the services of one company as distinguished from the services of another. Service marks are afforded similar protection under the law.

single-unit franchise: A franchisee who owns and operates a single franchise.

start-up costs: An estimate of the initial investment that the franchisee will make in becoming a franchisee. It's also known as an Item 7 disclosure. It generally includes the franchise fee, the cost of fixed assets, leasehold improvements, inventory, deposits, other fees and costs, and working capital required during the start-up period.

success: How do you define success: profit, growth, or return on investment? In some franchise systems, success often simply describes the absence of failure or the closing of a location. It may have nothing at all to do with unit sales or profitability. You can expect your start-up costs to vary based on your market and whether or not your franchisor's brand is well known in your area.

successor agreement: The franchisee's ability to continue in the business for additional terms following a successful completion of their initial term. Also known as *renewal*.

system brand fund: Although often confused with an advertising fund, a brand fund generally allows the franchisor to spend the brand fund on more than it can under an *advertising fund*.

trademark: The marks, brand name, and logo that identify a franchisor. It's the name that the franchisor licenses to the franchisee.

turnkey: A location that a franchisor builds and then sells to a franchisee fully equipped and ready to operate.

Index

A

ABA (American Bar Association), 76, 281, 331
accountants, finding, 280, 281
Ace Hardware, 146
acquiring an area, 232–234
action plan, creating, 284–285
ADA (Americans with Disabilities Act) (1990), 152, 169
adaptation costs, 328–329
adding franchises, 219–234
ADEA (Age Discrimination in Employment Act) (1967), 169
administrative assistant, 305
advisory councils, 195–196
AFEX Global Payment and Risk Management Solutions (website), 336–337
Affordable Care Act, 177
Age Discrimination in Employment Act (ADEA) (1967), 169
Agence Francaise de Developpement (website), 367
agency rules, for international franchises, 333
Ainsley, Kay (managing director), 321
Aire Serv, 300
Alphabet (Google), 370
alternate sites, 127
alternative distribution, 242
Amazon, 204
American Bar Association (ABA), 76, 281, 331
Americans with Disabilities Act (ADA) (1990), 152, 169
Americas Escape Games, 16
Amos, James (CEO), 52
Amos, Jim (board member), 358
angel investors, 116–117
Annual Franchise Development Report (Franchise Update Media), 298
Anytime Fitness, 15
appendix, in business plan, 109
Apple, 243
Applebee's, 146
appraisals, 251
approval committee, 306–307
approvals, getting, 137
approved standards, meeting, 141–145

arbitration, 333
Arby's, 15, 146
area
 acquiring an, 232–234
 development rights for, 232
 exclusive, 132–134
assets, 225
associations, 36–37
at-home sites, 126
AT&T, 370
attention to details, 380
attorney, importance of an experienced, 331–333
attracting veterans, 300
auditors, finding, 281
Auntie Anne's, 15
Australian Agency for International Development (website), 367
Austrian Development Agency (website), 367

B

back of the house, 136, 149–151
background checks, 173–174
“bad apples,” as a disadvantage of franchising, 46
balance sheet, 225
Bank of America, 370
Barr, David (founder of PMTP Restaurants), 221–222
base of the pyramid (BOP), 14, 350, 352–355
Batteries Plus Bulbs, 15
Beacham, Michael (president), 334
behavioral retargeting, for recruiting franchisees, 296
Belgium Foreign Affairs, Foreign Trade and Development Cooperation (website), 367
Bill & Melinda Gates Foundation, 369
BlueOrchard Finances, S.A., 370
bolt-on franchising, 359, 366–367
Bond, Robert (author)
 How Much Can I Make?, 113
BOP (base of the pyramid), 14, 350, 352–355
Bosley's, 15
brainstorming strategic plans, 283–284

- brand fund fee, 204–205
- brand promise, delivering on, 366–367
- brands, 9, 11, 256
- BRIC countries, 337–338
- Bright Star Care, 9, 16, 180–181
- brokers, role, risk and benefits of, 87–88
- Brown, Liam (president), 335
- Budget Blinds, 203
- budgeting
 - about, 225–226
 - for capital investment, 328–330
- Burger King, 56, 146
- business advisors, finding, 77
- business and finances, for adding franchises, 224–226
- business broker, 254
- business overlay, 285
- business plan, 105–109, 283–284
- business structure, in business plan, 107
- business-format franchising, 12–14
- business-to-business partnerships, 203
- buying
 - company-owned locations, 231
 - franchisor-owned locations, 37–38
- buying groups
 - about, 36–37
 - role of, 146–149

C

- calculating value, 250–251
- Canadian International development Agency (website), 367
- CAN-SPAM Act, 209
- capital
 - about, 97
 - determining investment, 100–104
 - evaluating current finances, 98–100
 - investing in international franchises, 325–326
 - raising, 114–117
 - requirements for, 375–376, 384–385
 - researching, 105–113
 - social franchising and funding, 117–120
- Capodice & Associates (website), 304
- capture cost, 328
- CareerBuilder (website), 167
- CARSTAR, 15
- Carvel, 15
- cash flow, 112–113, 226
- category killers, 125
- central business district (CBD), 126
- Central Intelligence Agency (CIA) (website), 322
- certificates of occupancy, 137
- Certified Franchise Executive (CFE) designation, 278, 282
- CFA (Coalition of Franchisee Associations), 197
- CFE (Certified Franchise Executive) designation, 278, 282
- CFWshops
 - about, 356
 - how it started, 356–358
 - hub-and-spoke model, 358–359
- chain, turning a small business into a, 260–262
- Chaitovsky, Aaron (CPA), 109
- challenges, of social franchising, 355–356
- change, dealing with, 191–194
- charity promotions, 209
- Chevron, 369
- Child and Family Wellness Shops. *See* CFWshops
- children, leaving a franchise to your, 246–247
- Children's Investment Fund Foundation, 369
- choosing locations, 124–128
- Church's Chicken, 334
- churning, 38
- CIA (Central Intelligence Agency) (website), 322
- Cinnabon, 15–16
- Citigroup, 370
- Civil Rights Act (1964), 168
- CKE Restaurants, 15–16
- closing the deal, as step in recruitment process, 312–313
- CMS (contact management system), 299, 303
- Coalition of Franchisee Associations (CFA), 197
- Coca-Cola, 12, 143, 370
- collaboration
 - about, 179
 - changing the system, 184–185
 - dealing with change, 191–194
 - meeting franchise system standards, 180–181
 - relationship building with fellow franchisees, 194–198
 - relationship building with franchisor, 185–191
 - rules of, 179–185
 - supporting and watching the system, 182–184
- commitment, importance of, 383
- community, for recruiting team members, 167

- community centers, 124–125
- community involvement, 378–379
- Community Reinvestment Fund, USA, 370
- company-owned locations, buying, 231
- competition, 231–232, 332
- competitive benefits, as an advantage of franchising, 43–44
- completion, as step in recruitment process, 313
- compliance officer, 306
- conflicts, 192–194
- Conrad N. Hilton Foundation, 369
- construction, beginning, 137
- consultants
 - becoming, 256
 - finding, 280
 - as a franchisee recruiter, 304
 - on law firms, 277
- “A Consumer’s Guide to Buying a Franchise” (FTC), 83
- contact management system (CMS), 299, 303
- continuing franchises, 238
- contracts, 134
- conventions, 332
- conversion franchisees, 78
- conversions, 39
- converting competitor’s locations, 231–232
- cooperatives, 207
- Corner Bakery Café, 15–16
- corporate philanthropists, 369–370
- corruption, for international franchises, 333
- costs
 - adaptation, 328–329
 - capture, 328
 - customs and duties, 330
 - development, 330
 - human resource, 329
 - legal, 324, 330
 - location, 103
 - onboarding, 329
 - operational, 329
 - pre-opening labor, 104
 - professional fees, 104
 - real estate, 330
 - recruiting, 329
 - regulatory, 330
 - startup, 101–102
 - training, 103–104, 329

- for training, 103–104
- transactional, 324
- transfer fees, 90, 252
- councils, 36–37
- Craigslist (website), 167
- Creating a Business Plan For Dummies* (Curtis), 109
- creating action plans, 284–285
- credit systems, as a financing strategy, 117
- Cresanti, Robert (author), 262
- cross-defaults, 222–223
- cross-selling, 203
- culture, implications of, 334–336
- cure periods, 78
- currency, for international franchises, 332
- currency-exchange, 336–337
- Curtis, Veechi (author)
 - Creating a Business Plan For Dummies*, 109
- customer service, 210–216, 378
- customers
 - about, 183, 199–200
 - creating a marketing plan, 200–204
 - customer service, 210–216
 - evaluating national and local advertising strategies, 204–210
 - knowing your, 210–211
- customs and duties costs, 330

D

- damages, for international franchises, 332–333
- Danish Ministry of Foreign Affairs (website), 367
- Darden Restaurants, 334
- Dat Dog, 9, 16, 350
- daypart, 127–128
- day-to-day basis, management on a, 255
- day-to-day operations, in business plan, 107–108
- deal structure, for foreign franchises, 323
- debt, avoiding, 114–115
- DEC (Development Economics Group) (World Bank), 337
- decision-making, as step in recruitment process, 312
- deferred payments, as a financing strategy, 117
- delegating responsibility, 223–224
- deliverables, 328
- deliveries, receiving, 147–148
- demand, for your products/services, 265–266
- demographics, of franchisees, 294

Department of Commerce
 Gold Key Matchmaking service (website), 327
 International Trade Administration (website), 337
Department of Housing and Urban Development (website), 167
Department of Labor (DOL), 155, 157–158, 177, 190
Department of the Treasury, 336
designing franchise systems, 275–282
developing
 franchise systems, 275–282
 legal documents, 285–286
 recruitment organization, 301–308
development agreement, 228
development costs, 330
Development Economics Group (DEC) (World Bank), 337
developmental benchmarks, for social franchises, 362–366
Devex (website), 369
DiPaola, Bill (president and COO), 9
Discovery Days, 86, 91, 168, 307, 311
discrimination, 168–169
dispute resolution
 about, 240–241
 for international franchises, 333, 346
distribution models, in social franchising, 361
Doing Business Project (Development Economics Group) (website), 337
DOL (Department of Labor), 155, 157–158, 177, 190
domestic franchise laws (website), 261
Domino's, 13
double bottom line, 361
dry storage, 150–151
dual branding, 127–128
due diligence, for interviews, 173–174
Dummies (website), 4, 64, 82, 83, 102, 284, 285, 313, 332, 338
Dunkin' Donuts, 56, 127, 146
Dutch East India Company, 8
Dutch Ministry of Foreign Affairs (website), 367
Dwyer, Dina (chairman of Dwyer Group), 300
Dwyer, Don, Sr. (founder of Dwyer Group), 300
Dwyer Group, 300

E

earnings claim, 73
e-commerce, 242
Econo Lube & Tune, 15–16

economic issues, for foreign markets, 322
EEOC (Equal Employment Opportunity Commission), 168–169
effectiveness, measuring for recruiting franchisees, 298–300
email marketing, 208–209
embassies, for international franchisees, 343–344
employees
 field, 182
 recruiting, 377
 for recruitment organization, 304–308
 training, 160–164, 378
employer, who is the, 157–158
employment agencies, for recruiting team members, 167
encroachment, 133, 134
end of franchises
 about, 235
 decision-making, 236–238
 leaving it to your children, 246–247
 post-franchise, 254–256
 selling, 247–254
 successor franchise, 238–243
 timing for, 244–245
English, as a primary language, 162–163
Enovana, 16
entering foreign markets, 342–344
enthusiasm, 377
Entrepreneur (website), 84
entrepreneurs
 defined, 288
 vs formula entrepreneur, 255
EPA (Equal Pay Act) (1963), 169
Equal Employment Opportunity Commission (EEOC), 168–169
equal opportunity guidelines, 168–169
Equal Pay Act (EPA) (1963), 169
eSpatial (website), 227
Esri (website), 227
E-Verify (website), 169
exclusive areas, 132–134
exclusive territory, 17
executing contracts, for international franchises, 333
executive recruiters, for recruiting team members, 167
executive search firm, 304
executive summary, in business plan, 106
exit value, 225
experiences, reflecting on, 254–255

expositions, 85–86
extension fee, 234
ExxonMobil, 369

F

Faber, Gunther (vice president), 357
Facebook, 296
FACs (franchisee advisory councils), 18, 185, 195–196
family business, 246–247
FAN (Franchise Action Network), 379
FASTSIGNS, 16
FDD. *See* franchise disclosure document (FDD)
Federal (Lanham) Trademark Act (1946), 56, 160
fees for services, 190–191, 238–239
Feltenstein, Sid (board member), 358
FERF (Franchise Education and Research Foundation), 247, 278
Féria Internationale de Franquicias, Mexico City, 85
field consultant, 181, 182
field staff, 182
finalizing selection process of franchisees, 318
financial advisors, finding, 77
financial performance representation (FPR), 73–75, 89–90
financial statements, for international franchises, 332
financing benchmarks, for social franchises, 108, 362–366
finding
 business advisors, 77
 financial advisors, 77
 formula entrepreneurs, 288–289
 franchise recruiting professional, 304
 franchisees for international franchises, 341–342
 lawyers, 76–77
 locations, 128–132
 professional advisors, 280–282
Finnish Ministry for Foreign Affairs (website), 368
Firehouse Subs, 13, 16, 260
Fishman, Sherri (president of Fishman PR), 203–204
Five Guys, 260
Five Star Painting, 300
focusing your market strategy, 289–291
fogging the mirror strategy, 291
follow up after discovery day, as step in recruitment process, 311–312
follow up again, as step in recruitment process, 312
footprint, 136
Ford Foundation, 369
Ford Motor Company, 12
foreign markets, entering, 342–344
formula entrepreneur
 about, 42
 vs entrepreneur, 255
 finding, 288–289
Forum on Franchising (ABA) (website), 76, 331
Foumami, 16
four Ps, 199–200
14-day rule, 59–60, 315
FPR (financial performance representation), 73–75, 89–90
fractional franchising, 359, 366–367
Franchise Action Network (FAN), 379
franchise agreement
 about, 75
 as a disadvantage of franchising, 47
 multi-unit operations and, 222–223
Franchise Attorney Directory (website), 76
franchise attorneys, finding, 280, 281
franchise brokers, role, risk and benefits of, 87–88
franchise consultants
 becoming, 256
 finding, 280
 as a franchisee recruiter, 304
 on law firms, 277
franchise development professionals, finding, 281
franchise development staff, 305
franchise disclosure document (FDD)
 about, 55–56, 58, 60
 agreements to sign, 73
 bankruptcy, 63
 business experience, 62
 components of, 58–59
 contracts, 71
 cover page, 60–61
 financial performance representation, 68–70
 financial performance representation (FPR), 73–75
 financial statements, 70–71, 72–73
 financing available, 66
 14-day rule, 59–60, 315
 franchisee's obligations, 65–66
 franchisor and its parents, predecessors, and affiliates, 61–62
 franchisor's obligations, 66–67, 72

- franchise disclosure document (FDD) (*continued*)
 - initial franchise fee, 63
 - initial investment, 64, 71
 - list of franchise units, 70, 72
 - litigation, 62
 - obligations to participate in the actual operation of the franchise business, 67
 - other fees, 63–64
 - patents, copyrights, and proprietary information, 67
 - public figures, 68
 - receipt, 71
 - renewal, termination, transfers, and dispute resolution, 68, 72
 - restriction on sources of products and services, 64–65, 71
 - restrictions on what the franchisee may sell, 68
 - in sales presentation, 315–318
 - territory, 67
 - trademarks, 67
- Franchise Education and Research Foundation (FERF), 247, 278
- Franchise Expo South, 85, 297
- Franchise Expo West, 85, 297
- franchise fee, 9, 102–103, 233, 273
- Franchise Forum (ABA), 281
- franchise laws (website), 261
- franchise lawyer, 304
- Franchise Opportunities Guide* (IFA), 84, 99, 296
- franchise packagers, 277–280
- franchise professionals, hiring, 386–387
- franchise recruiting professional, finding, 304
- franchise registration, 261–262
- Franchise Registry (SBA) (website), 110
- franchise systems
 - ad campaign, 204–206
 - changing the, 184–185
 - considerations about, 382
 - designing, 275–282
 - developing, 275–282
 - establishing a, 270–271
 - following the, 376
 - handling change in the, 191–192
 - meeting standards, 180–181
 - supporting and watching, 182–184
 - teaching your, 271–272
- Franchise Times*, 84, 297
- franchise trade shows, for recruiting franchisees, 297
- Franchise UPDATE* (magazine), 84
- Franchise Update Media, 84, 297, 298
- franchisee advisory councils (FACs), 18, 185, 195–196
- franchisee associations, 196–197
- franchisee partner, 288
- franchisees
 - about, 287
 - building relationships with fellow, 194–198
 - buying franchises from other, 229–230
 - characteristics of ideal, 287–289
 - developing recruitment organization, 301–308
 - fellow, 184
 - finalizing selection process of, 318
 - finding for international franchises, 341–342
 - finding through media, 294–300
 - franchise packagers, 293–294
 - getting on your own, 293–294
 - maintaining contact with fellow, 379
 - market strategy focus, 289–291
 - marketing for, 294–298
 - potential, 268–270
 - profile for, 291–293
 - recruiting, 287–318
 - relationship between franchisor and, 255
 - requirements for, 385
 - roles and goals of, 15, 16–18
 - sales presentation for, 315–318
 - in social franchises, 360–361
 - steps to recruiting, 308–313
 - success of, 375–380
 - talking to other, 95–96
 - training, 383–384
 - validation process for, 313–315
- franchise-package firms, 293
- franchises
 - about, 9
 - adding, 219–234
 - continuing, 238
 - end of. *See* end of franchises
 - existing, 89–91, 99–100
 - leaving, 237
 - meeting requirements for, 136–138
 - new opportunities, 91–92
 - offerings from, 92–96
 - regulations for, 56–57
 - selling, 237, 247–254
 - vs. small business, 42–43

successor, 235, 238–243
 switching, 237–238
 working from home, 126
 The Franchise Show, Ireland, 85
 The Franchise Show, London, 85
 franchising. *See also* international franchising; social franchising; *specific topics*
 about, 9, 386
 as an industry, 288
 bolt-on, 359, 366–367
 business-format, 12–14
 commitment to, 266–268
 effects on modern business of, 9–10
 fractional, 359, 366–367
 history of, 7–8, 56–57
 statistics on, 10
 success of for business owners, 10
 traditional, 12
 types of, 12–15
Franchising World (website), 84
 franchisor/franchisee relationship, 18–19
 franchisor-owned locations, buying, 37–38
 franchisors
 about, 9
 becoming a, 256, 259–286, 381–387
 building relationships with your, 185–191
 business issues of becoming a, 282–286
 criteria for becoming a, 262–275
 designing and developing your franchise, 275–282
 designs from, 136
 as a franchisee recruiter, 304
 location help from, 130–131
 maintaining contact with, 379
 negotiating with, 77–78
 relationship between franchisee and, 255
 right of first refusal, 251
 role of in human resources policies, 158–160
 roles and goals of, 15–16
 in social franchises, 360–361
 as sole supplier, 142
 suppliers approved by, 142–143
 verbal promises by, 75
 working for the, 256
 FranConnect (website), 303
 Franklin, Benjamin (author)
 Poor Richard's Almanack, 8

FranNet (website), 87
 Franquicias Expo, Guadalajara, 85
 FRM Solutions (website), 303
 front of the house, 152
 FTC Rule, 55, 57, 160, 230, 333

G

Gardere, 276, 278
 General Mills, 370
 Genetic Information Nondiscrimination Act (GINA) (2008), 169
 Genius Bar (Apple), 243
 geographic characteristics, of franchisees, 294
 Gesellschaft für Internationale Zusammenarbeit (website), 368
 Gilead Sciences, 369
 GINA (Genetic Information Nondiscrimination Act) (2008), 169
 Glass Doctor, 300
 Gold Key Matchmaking service (U.S. Department of Commerce) (website), 327
 Goldman Sachs Group, 369
 Gordon and Betto Moore Foundation, 369
 governing laws, for international franchises, 333
 government funding agencies, for global development, 367–368
 Great Expressions Dental Centers, 15–16
 Greek Ministry of Foreign Affairs (website), 368
 Greenbaum, Steve (board member), 358
 Grounds Guys, 300
 GsBIS (website), 227
 guaranties, for international franchises, 333
 Guidant Financial, 115

H

Hashim, Aziz (managing partner), 100
 Hillstrom, Scott (founder of CWshops), 354, 356. *See also* CFWshops
 hiring. *See also* recruiting
 about, 153
 conducting interviews, 169–174
 employer, 157–158
 franchise professionals, 386–387
 role of franchisor in human resources policies, 158–160
 work environment, 174–178

history, of franchising, 7–8
Holiday Inn, 56
home, working franchises from, 126
Home Service Stores, 15–16
honesty, showing, 212–213
Hot Dish Advertising, 11
How Much Can I Make? (Bond), 113
H&R Block, 56
hub-and-spoke model, 358–359
human resource costs, 329
hybrid social/microfranchise, 352

I

I&A (Industry & Analysis) unit (ITA), 343
IBA (International Bar Association), 332
icons, explained, 3
IFA. *See* International Franchise Association (IFA)
IFC (International Finance Corporation) (website), 337
IFE (International Franchise Exposition), 297, 343
IFX Franchise Management Platform (website), 303
IHOP (International House of Pancakes), 56, 140, 146
Il Fornalo, 15–16
Immigration Reform and Control Act (1986), 169
impact investors, 370
implementation plan and timetable, in business plan, 108
Inc. (website), 84
incentives, 201
income, projecting, 112–113
income expectations, elevated, as a disadvantage of franchising, 46–47
incumbent inertia, 260
Indeed (website), 167
indemnification, for international franchises, 332–333
independence, loss of, as a disadvantage of franchising, 45
industry, franchising as an, 288
industry analysis and background, in business plan, 86–87, 107
Industry & Analysis (I&A) unit (ITA), 343
inelasticity, as a disadvantage of franchising, 47
initial training, 154–156
integrity, showing, 212–213
intellectual property (IP), 262, 275–276, 332, 338
Interim Health Care, 13
internal buy-in, for foreign franchises, 323
International Bar Association (IBA), 332
International Council of Shopping Centers (website), 129
International Finance Corporation (IFC) (website), 337
International Franchise Association (IFA)
 Code of Ethics (website), 83
 Franchise Education and Research Foundation (website), 247, 278
 Franchise Opportunities Guide, 84, 99, 296
 monthly meetings, 379
 ombudsman program, 194, 241
 Overtime Compliance Tool, 177
 for recruiting franchisees, 296
 Social Sector Franchising Task Force (website), 371
 Statement of Guiding Principles (website), 83
 Supplier Forum (website), 76, 77, 282, 304, 331
 trade missions, 343
 VetFran, 52, 117, 300
 website, 83, 296
international franchise consultant broker, 327–328
International Franchise Expo, New York City, 85
International Franchise Exposition (IFE), 297, 343
international franchise laws (website), 261
international franchising
 about, 319–320
 bringing foreign franchises to the U.S., 346–348
 considerations for, 320–338
 decision-making for, 338–340
 entering foreign markets, 342–344
 finding franchisees, 341–342
 negotiating deals, 344–346
International Franchising Committee (IBA) (website), 332
International House of Pancakes (IHOP), 56, 140, 146
International Trade Administration (ITA), 337, 343
Internet, 83
interviews, conducting, 169–174
intranet designers, finding, 281
introductory phase, as step in recruitment process, 309–311
inventory, maintaining, 149–152
investing
 capital in international franchises, 325–326
 determining, 100–104
 in multiple units, 228
Investopedia (website), 370
invoices, verifying, 149
IP (intellectual property), 262, 275–276, 332, 338

Irish Department of Foreign Affairs (website), 368
ITA (International Trade Administration), 337, 343
Italian Ministry of Foreign Affairs' Directorate General
for Development Cooperation (website), 368

J

Japan International Cooperation Agency (website), 368
Jimmy John's, 15–16
job postings, for recruiting team members, 167
John D. and Catherine T. MacArthur Foundation, 369
John Deere, 12
joint employment
 about, 155, 157
 role of franchisor in human resources policies, 158–160
 who is the employer, 157–158
joint ventures
 about, 35–36
 as a financing strategy, 117
 for international expansion, 341–342
JPMorgan Chase, 369

K

Kane, Dawn (CEO), 11
Kentucky Fried Chicken (KFC), 56, 127, 334, 335
key drop delivery, 147
key money, 325
key performance indicators (KPIs), 275
KFC (Kentucky Fried Chicken), 56, 127, 334, 335
Korea International Cooperation Agency (website), 368
KPIs (key performance indicators), 275
Kreditanstalt für Wiederaufbau (website), 368
Kroger, 370

L

language, implications of, 334–336
Law Business Research, Ltd., 332
laws, for foreign franchises, 324
lawyers, finding, 76–77
lead-generation sites, for recruiting franchisees, 296
lease, signing the, 135–136
leasing, as a financing strategy, 117
leaving franchises, 237
legal costs, 324, 330

legal documents, developing, 285–286
legal issues, 55–56
liabilities, 225, 332–333
licenses, getting, 137
lifestyle centers, 125
LinkedIn, 296
liquid capital, 101
liquidated damages agreement, 332–333
local advertising strategies, evaluating, 204–210
local banks, 115–116
local economic issues, for foreign markets, 322
local laws, for foreign franchises, 324
local marketing, 206–210
localizing, 384
Locatec, 300
locations
 about, 96, 123
 choosing, 124–128
 competitor, 231–232
 costs, 103
 encroachment policies, 134
 finding, 128–132
 meeting franchise requirements, 136–138
 nontraditional, 39, 242
 protected and exclusive areas, 132–134
 signing a lease, 135–136
Logan, Gordon (CEO), 13
logistics, for foreign franchises, 323
London Company, 8
LongHorn Steakhouse, 334
loves ones, neglecting, 376
Luxembourg Ministry of Foreign Affairs (website), 368
Lyft, 260

M

Maaco, 15–16
MacPhee, Len (attorney), 141
malls, 124
management and organization structure, in business
 plan, 108
managers
 hiring good, 176
 vs operator, 223
mandatory purchases, 141–145
mapping software, 227

Maptitude, by Caliper (website), 227
market analysis and strategy
 in business plan, 107
 focusing your, 289–291
marketing
 defined, 199
 for franchisees, 294–298
 local, 206–210
marketing plan, creating, 108, 200–204
marketing professionals, finding, 281
Marriott, 350
Massage Envy, 15–16
mass-gathering, 127
master franchising, for international expansion, 341
Mazero, Joyce (author)
 acting on behalf of IHOP and Applebee's, 146
 on contracts, 134
 influence of, 262
 referrals from, 76
 as a source, 282
McAlister's Deli, 15–16
McBride, Julie (senior consultant), 14, 358
McCarthy, Eric (board member), 358
McDonald's, 13, 56, 263, 335, 350, 357
measuring effectiveness of franchisee recruitment,
 298–300
media, for finding franchisees, 294
meets brand standards, 162
Meineke, 15–16
Merck, 370
Merlin, 15–16
mets and bounds, 17
MFV Expositions (website), 297, 343
microfranchise, compared with social franchise, 352
Microsoft, 370
Midas, 56
Millennium Challenge Corporation (website), 368
Miller's Ale House, 15–16
mission statement, in business plan, 106
mobile device optimization, for recruiting franchisees,
 295–296
Moe's Southwest Grill, 15–16
Molly Maid, 300
Monster (website), 167
Morgan Stanley, 370

Mr. Appliance, 300
Mr. Electric, 300
Mr. Handyman, 300
Mr. Rooter, 300
MSA Worldwide, 14, 278, 308, 326, 349, 366
Multi-Unit Franchisee (magazine), 84
multi-unit operations
 advantages of, 220–221
 cross-defaults, 222–223
 disadvantages of, 221–222
 for international expansion, 341
 investing in, 228
 proximity of, 230
 purchase options for, 227–234
 resources for, 223–226
mystery shoppers, 183

N

Naf Naf, 15–16
Naranaga (website), 303
national advertising strategies, evaluating, 204–210
National Labor Relations Board (NLRB), 155, 157–158,
 190
Nation's Restaurant News (website), 85
negotiating
 with franchisors, 77–78
 international franchise deals, 344–346
negotiating box, 327
Negotiating Commercial Leases & Renewals For Dummies
 (Willerton), 136
neighborhood centers, 124
networking, for recruiting team members, 167
New Zealand Aid Program (website), 368
The New York Times (website), 85
next gen programs, 246–247
NGOs (nongovernmental organizations), 14–15,
 117–120, 351
NLRB (National Labor Relations Board), 155, 157–158,
 190
non-compete clause, 256
non-geographic retail, 243
nongovernmental organizations (NGOs), 14–15,
 117–120, 351
nontraditional locations, 39, 242
Norwegian Ministry of Foreign Affairs (website), 368

O

Occupational Safety and Health Act, 177
Occupational Safety and Health Administration (OSHA), 177
Office of Foreign Assets Control (OFAC) (U.S. Department of the Treasury), 322, 336
office support, 190
off-street sites, 126, 127
Olive Garden, 334
ombudsman, 241
ombudsman program (IFA), 194, 241
onboarding costs, 329
1-800 Radiator, 15
ongoing benefits, as an advantage of franchising, 45
ongoing training, 156–157
Open Society Foundations, 369
openings, franchisor help with, 138
operating budget, 225–226
operational costs, 329
operator, vs manager, 223
Orangetheory Fitness, 15–16
organization, for adding franchises, 224
organizers, 288
OSHA (Occupational Safety and Health Administration), 177
overdependence, as a disadvantage of franchising, 45–46
Overtime Compliance Tool (IFA), 177
ownership rules, for international franchises, 333

P

packaging firms, 261, 277–280, 293
partner, 288
passing the mirror test, 92
patronage dividends, 146
people person, being a, 52–53, 255
Pepsi, 143
permits, getting, 137
Pet Supermarket, 15–16
Pet Valu, 15–16
Pfizer, 370
PFK, 334
PharmAccess Foundation, 358
philanthropy, 368–370
Pizza Hut, 127
P&L (profit and loss statement), 226
place, as one of four Ps, 200

plan-o-gram, 150
Play This icon, 3
PNC Financial Services, 370
Poor Richard's Almanack (Franklin), 8
Population Services International (PSI), 359
Portland Glass, 300
Portuguese Institute for Development Support (website), 368
PostNet, 13
power centers, 125
PR (public relations), 297–298
Pregnancy Discrimination Act, 169
pre-opening benefits, as an advantage of franchising, 44
pre-opening labor costs, 104
pre-sale agreements, 261–262
price, as one of four Ps, 200
Primrose Schools, 15–16
print directories, 84
private philanthropic foundations, 368–369
Pro Oil Change, 15–16
products
 checking, 148–149
 demand for your, 265–266
 for foreign markets, 322
 as one of four Ps, 199
 quality of your, 272, 382
 receiving, 147
 sourcing, 337
professional advisors, finding, 75–77, 280–282
professional fees, 104
profit and loss statement (P&L), 226
projecting income and cash flow, 112–113
promotion, as one of four Ps, 200
Protect Painters, 300
protected areas, 132–134
protected territory, 17
protecting trademarks and trade secrets, 337–338
protocols, 332
proximity, of multi-unit operations, 230
PSI (Population Services International), 359
psychographics, of franchisees, 294
public relations (PR), 297–298
publications, 84–85
purchase options, for adding franchises, 227–234
purchasing cooperatives, role of, 146–149
PuroClean, 13

Q

quick service restaurant (QSR), 189

R

Rainbow International, 300

R&D (research and development), 189

real estate costs, 330

“Reality Check at the Bottom of the Pyramid” (Simanis), 355

rebates, 143–145, 241

receipt of merchandise, 147

recruiting

costs of, 329

franchisees, 287–318

process of, 308–313

staff, 377

staffing your recruitment organization, 304–308

team members, 166–168

referral network, for recruiting team members, 167

referrals, 281, 344

reflecting on experiences, 254–255

refranchising, 37–38, 291

refrigerated storage, 151

regulations

for franchises, 56–57

state, 57–58

regulatory costs, 330

The Reinvestment Fund, 370

relationships

building with franchisor, 185–191

rules for international franchises, 333

religious law, for international franchises, 333

remarketing, for recruiting franchisees, 296

Remember icon, 3

repatriation, for international franchises, 332

resale listing service, 254

research, 81–83

research and development (R&D), 189

resources

for multi-unit operations, 223–226

for social franchising, 367–370

responsibility, delegating, 223–224

retail theater, 242–243

retargeting, for recruiting franchisees, 296

retrofranchising, 37–38, 231, 291

return on investment (ROI), 225

revenue, 104

rewarding team members, 166–168

right of first refusal, 78, 229, 251

Roark Capital, 15

Rockefeller Foundation, 369

ROI (return on investment), 225

Roosevelt, Franklin (U.S. President), 352–353

Rosner, Marla (consultant), 163

royalties, 8, 273

Russell, Paul V. (senior counsel), 56

S

sales brokers, 87

sales methods, for franchises, 253–254

sales presentation, for franchises, 315–318

same-store sales (SSS), 275

SBA (Small Business Administration), 109–112

SBA Standard Addendum, 110–111

scaling, 361

Schlotzky's, 15–16

scope

about, 21–22

adding franchises, 27–29

becoming a master franchisee, 32–34

developing your own territory, 29–32

single franchise, 22–27

screener, 305

search engine optimization (SEO), 202, 296

Seid, Michael (author)

CFWshops and, 358

as a franchise consultant, 256, 259

influence of, 262

referrals from, 76

on retail theater, 242–243

as a source, 282

self-evaluation

about, 41–42

process of, 49–54

pros and cons of franchising, 43–49

small business vs franchise, 42–43

selling franchises, 237, 247–254

SEO (search engine optimization), 202, 296

services

demand for your, 265–266

- for foreign markets, 322
- quality of your, 272, 382
- 7-Eleven, 16, 56
- shopping areas, 126
- shrinkage, 380
- signing the lease, 135–136
- Simanis, Erik (author)
 - “Reality Check at the Bottom of the Pyramid,” 355
- SiriusXM, for recruiting franchisees, 297
- site criteria, 131
- small business
 - vs franchise, 42–43
 - franchising, 383
 - owners becoming franchisors, 259–265
 - turning into a chain, 260–262
- Small Business Administration (SBA), 109–112
- social franchising
 - about, 14–15, 117–120, 349–351
 - base of the pyramid (BOP), 352–355
 - brand promise delivery, 366–367
 - CFWshops, 356–359
 - challenges for, 355–356
 - compared with microfranchising, 352
 - developmental benchmarks for, 362–366
 - distribution models in, 361
 - financing benchmarks for, 362–366
 - franchisees in, 360–361
 - franchisors in, 360–361
 - IFA task force, 371
 - resources for, 367–370
- social impact investment, 117
- social media
 - about, 183
 - managing, 201–202
 - for recruiting franchisees, 296
- Social Sector Franchising Task Force (IFA) (website), 371
- sole supplier, franchisor as, 142
- The South Carolina Gazette*, 8
- Spanish Ministry of Foreign Affairs and Cooperation (website), 368
- specialty centers, 125
- specifications, meeting, 141–145
- spiffs, 87
- spokesperson, 203
- sponsorship, 208
- Sport Clips, 13, 16
- SSS (same-store sales), 275
- Starbucks, 242
- startup costs, 101–102
- state regulations, 57–58
- statistics, on franchising, 10
- Stewart, Julia (CEO), 146–147
- stockroom, 149–150
- strategic plans, brainstorming, 283–284
- students, rewarding, 208
- subfranchisees, 232–233
- Subway, 146
- successor fee, 238–239
- successor franchise, 235, 238–243
- successor franchise agreement, 239–240
- Sun, Shelly (founder of BrightStar Care), 180
- supplier financing, as a financing strategy, 117
- Supplier Forum (IFA) (website), 76, 77, 282, 304, 331
- supplier-dealer relationships, 12
- suppliers, 142–143, 145
- supply chain
 - about, 139–140
 - approved standards and specifications, 141–145
 - basic requirements for, 140–141
 - for foreign franchises, 323
 - maintaining inventory, 149–152
 - role of buying groups and purchasing cooperatives, 146–149
- supply chain rebates, 241
- support, for foreign franchises, 324
- Swedish International Development Cooperation Agency (website), 368
- Swiss Agency for Development and Cooperation (website), 368
- switching
 - brands, 256
 - franchises, 237–238
- systems
 - ad campaign, 204–206
 - changing the, 184–185
 - considerations about, 382
 - designing, 275–282
 - developing, 275–282
 - establishing a, 270–271
 - following the, 376
 - handling change in the, 191–192
 - meeting standards, 180–181
 - supporting and watching, 182–184
 - teaching your, 271–272

T

Taco Bell, 127, 146, 335
Take 5 Oil Change, 15–16
Target, 370
taxes, for international franchises, 332
team leader, vs team player, 223
team player
 being a, 186–187
 vs team leader, 223
teams, 164–169
Technical Stuff icon, 3
temporary employees, 110–111
terminations, 176
territorial rights, 241–242
Texas Chicken, 334
theme/festival centers, 125
third-party intermediaries, working with, 326–328
threshold analysis, 263, 275
timing
 for adding franchises, 224
 for ending a franchise, 244–245
Timothé, Elizabeth (franchisee), 8
Tip icon, 3
trade missions, for international franchisees, 343
trade secrets, protecting, 337–338
trade shows, 85–86, 297, 343
trademarks, protecting, 337–338
trading area, 132
traditional franchising, 12
training
 about, 153
 building a team, 164–169
 costs for, 103–104, 329
 effective leadership, 164–169
 employees, 378
 for foreign franchises, 324
 franchisees, 383–384
 initial, 154–156
 ongoing, 156–157
 program for, 95
 staff, 160–164
transactional costs, for foreign franchises, 324
transfer fee, 90, 252
translation issues, for foreign franchises, 323–324
Transparency International (website), 322

Triodos Investment Management, 370
Twin Peaks, 13
2014 Millennium Development Goals (MDG) Gap Task Force Report, 354
2030 Sustainable Development Goals (website), 350

U

Uber, 260
U.K. Department for International Development (website), 368
United Nations Foundation, 369
United States, bringing foreign franchises to the, 346–348
upcharges, 143–145
U.S. Agency for International Development (website), 368
USA Today (website), 85

V

validation process, for recruiting franchisees, 313–315
valuations, 250–251
variances, 137
verbal promises, by franchisors, 75
verifying invoices, 149
veterans, 52, 300
VetFran (IFA), 52, 117, 300
VetFran Toolkit (website), 300
Vital Capital Fund, 370
volume rebates, 144

W

The Wall Street Journal (website), 85
Walmart, 369
Warning icon, 3
Waxing the City, 15–16
Web, 183
website designers, finding, 281
websites
 accountants, 77
 AFEX Global Payment and Risk Management Solutions, 336–337
 Agence Francaise de Developpement, 367
 Annual Franchise Development Report (Franchise Update Media), 298
 Australian Agency for International Development, 367
 Austrian Development Agency, 367

Belgium Foreign Affairs, Foreign Trade and Development Cooperation, 367
 CaerBuilder, 167
 Canadian International development Agency, 367
 CAN-SPAM Act, 209
 Capodice & Associates, 304
 Central Intelligence Agency (CIA), 322
 Coalition of Franchisee Associations (CFA), 197
 "A Consumer's Guide to Buying a Franchise" (FTC), 83
 contact management system (CMS), 303
 Craigslist, 167
 Danish Ministry of Foreign Affairs, 367
 Department of Housing and Urban Development, 167
 Devex, 369
 Doing Business Project (Development Economics Group), 337
 domestic and international franchise laws, 261
 Dummies, 4, 64, 82, 83, 102, 284, 285, 313, 332, 338
 Dutch Ministry of Foreign Affairs, 367
 embassies, 343–344
Entrepreneur, 84
 Equal Employment Opportunity Commission (EEOC), 168–169
 eSpatial, 227
 Esri, 227
 E-Verify, 169
 expositions, 85
 family business centers, 247
 Finnish Ministry for Foreign Affairs, 368
 Fortune 500 companies, 369
 Forum on Franchising (ABA), 76, 331
 Franchise Action Network (FAN), 379
 Franchise Attorney Directory, 76
 franchise business network groups, 195
 Franchise Education and Research Foundation (IFA), 247
 Franchise Opportunities Guide (IFA), 99
 Franchise Registry (SBA), 110
Franchise Times, 84, 297
Franchise UPDATE, 84
 Franchise Update Media, 84, 297
 franchise-opportunity, 83
Franchising World, 84
 FranConnect, 303
 FranNet, 87
 FRM Solutions, 303
 Gardere, 276
 Gessellschaft für Internationale Zusammenarbeit, 368
 Gold Key Matchmaking service (U.S. Department of Commerce), 327
 Greek Ministry of Foreign Affairs, 368
 GsBIS, 227
 Guidant Financial, 115
 hybrid social/microfranchise, 352
 IFX Franchise Management Platform, 303
Inc., 84
 Indeed, 167
 Industry & Analysis (I&A) unit (ITA), 343
 International Council of Shopping Centers, 129
 International Finance Corporation (IFC), 337
 International Franchise Association (IFA), 83, 296
 International Franchise Exposition (IFE), 343
 International Franchising Committee (IBA), 332
 International Trade Administration (U.S. Department of Commerce), 337
 Investopedia, 370
 Irish Department of Foreign Affairs, 368
 Italian Ministry of Foreign Affairs' Directorate General for Development Cooperation, 368
 Japan International Cooperation Agency, 368
 Korea International Cooperation Agency, 368
 Kreditanstalt für Wiederaufbau, 368
 legal issues, 332
 Luxembourg Ministry of Foreign Affairs, 368
 mapping software, 227
 Maptitude, by Caliper, 227
 MFV Expositions, 297, 343
 Millennium Challenge Corporation, 368
 Monster, 167
 MSA Worldwide, 326, 349
 Naranaga, 303
Nation's Restaurant News, 85
 New Zealand Aid Program, 368
The New York Times, 85
 Norwegian Ministry of Foreign Affairs, 368
 ombudsman program (IFA), 194, 241
 Overtime Compliance Tool (IFA), 177
 Portuguese Institute for Development Support, 368
 "Reality Check at the Bottom of the Pyramid" (Simanis), 355
 for recruiting franchisees, 295
 Roosevelt, Franklin (U.S. President), 352
 SiriusXM, 297

websites (*continued*)

Small Business Administration (SBA), 109
Social Sector Franchising Task Force (IFA), 371
Spanish Ministry of Foreign Affairs and Cooperation, 368
Supplier Forum (IFA), 76, 77, 282, 304, 331
Swedish International Development Cooperation Agency, 368
Swiss Agency for Development and Cooperation, 368
threshold analysis, 275
trade missions (IFA), 343
Transparency International, 322
2030 Sustainable Development Goals, 350
U.K. Department for International Development, 368
U.S. Agency for International Development, 368
USA Today, 85
validation services, 315
VetFran (IFA), 52, 300
VetFran Toolkit, 300
The Wall Street Journal, 85
Who's Who Legal, 332
workplace safety, 178
World Bank, 337
World Franchise Council (WFC), 296, 344
World Intellectual Property Organization (WIPO), 338
Zip Recruiter, 167
Wells Fargo, 369
Wetzel's Pretzels, 9, 140

WFC (World Franchise Council), 296–297, 344
Who's Who Legal (website), 332
Willerton, Dale (author)
 Negotiating Commercial Leases & Renewals For Dummies,
 136
William and Flora Hewlett Foundation, 369
Window Genie, 300
Wing Street, 127
WIPO (World Intellectual Property Organization)
 (website), 338
Woman 360 birthing center, 358–359
word of mouth, 166, 200
work environment, maintaining a good, 174–178
working capital, 104
workplace safety, ensuring, 177–178
World Bank, 337
World Franchise Council (WFC), 296–297, 344
World Intellectual Property Organization (WIPO)
 (website), 338
The World Factbook, 322

Y

Yum! Brands, 127

Z

Zip Recruiter (website), 167

About the Authors

Michael H. Seid is the founder and managing director of MSA Worldwide, a firm the International Franchise Association (IFA) has called “the leading strategic and tactical advisory firm in franchising.” He began his career at the age of 6, working in his family’s business, Ruth and Dave’s, in Brooklyn, New York. He traces his love of small business and success to the lessons he learned about quality, consistency, business finance, entrepreneurship, ethics, fair play, and a deep respect for the customer from working with his family. It was the way his parents managed the customer experience that inspired his approach for brick-and-mortar businesses to compete in an e-commerce environment through *retail theater*.

Michael entered college a bit earlier than most and took a break from his studies to serve in the U.S. Army, discharged as a staff sergeant. In the military he learned the importance of standards, the meaning of leadership, and that being part of a well-functioning and focused team that could rely on each other was necessary to achieve every goal. That’s why, he believes, veterans make such great franchisees and franchisors.

Michael became a CPA and then senior operations officer in franchised and non-franchised corporations. He married his high-school sweetheart Susan, his bride and love for more than 40 years, and watched his two children Rachel and Drew grow up to be lawyers and business professionals. Drew agreed a few years back to leave the practice of law and bring his talents as a businessperson to MSA Worldwide. Of exceptional importance are Anabel and David, his grandchildren, and his son-in-law Michael, who is an amazing young man.

During a career in franchising spanning more than 30 years, Michael has been a senior operations and financial executive or consultant. He has also been a franchisee. Michael is the first professional ever directly elected to the board of the IFA, a role he has been fortunate to serve for more than a decade. He is the past chair of the IFA’s Supplier Forum and a former member of the IFA’s Executive Committee. He frequently testifies on legislative matters for the IFA.

MSA’s clients are diverse and aren’t limited to those in franchising. The firm’s primary clients are small and mid-sized companies, but MSA also is fortunate to routinely work with many of the world’s largest franchisors and nonfranchisors in the United States and abroad as strategist, tactician, and litigation expert in complex legal matters. Some of MSA’s core practice offerings include the design and development of emerging franchise systems, social franchising, domestic and international expansion and support, the development of headquarters and field support systems, manuals and training programs, franchise relations, and the restructuring of established franchise systems. Michael is a noted author, oft-quoted expert in the field, and frequent speaker. He has received numerous awards, is an active social franchisor, and serves on university and legislature-appointed

boards. His e-mail address is mseid@msaworldwide.com (www.msaworldwide). He can also be reached at 860-523-4257.

Joyce Mazero is partner and co-chair of the Global Supply Network at Gardere Wynne Sewell LLP. With a legal career spanning more than 35 years, Joyce has established an international reputation as a strong and strategic lawyer and a trusted business advisor in the franchising, supply chain, food service, restaurant, and retail industries. At Gardere she leads the team and its interdisciplinary group of professionals, all of whom advise national and multinational franchised and independent businesses on building and expanding chains across the globe.

Throughout her career, Joyce has led numerous projects for small and large entrepreneurial and experienced companies. Her work primarily focuses on the food service, restaurant, and retail industries. Joyce has represented some of the world's best-known brands including IHOP, Applebee's, Ruby Tuesday, Cheddar's Scratch Kitchen, Tempur Sealy, Interstate Battery, Olive Garden, and Bojangles. Her numerous projects include development of intellectual property, sourcing, manufacturing, warehousing, transportation, selling, acquiring, and financing all types of businesses, as well as franchising, licensing, and other methods of distribution.

Known for being a tenacious advocate, Joyce was recognized early in her career by restaurant legend Norman Brinker (Chili's) for her work on one of Brinker's first international deals. It is that support and the collective experience, wisdom, and advice of senior executives such as Julia Stewart (DineEquity), Sarah Palisi Chapin (Burger King, Hail Merry), Bill Hyde (Ruth's Chris), Jeff Rogers (Pizza Inn), and Greg Walther (Outback Steakhouse) that have fueled Joyce's commitment to the law and franchising, paving the way for her storied career.

Since 2008, Joyce has been annually top-ranked as one of the nation's leading franchise attorneys by *Chambers USA*, and she is internationally recognized as a leading franchise attorney by *Chambers Global*. Joyce's clients recognize her as having a "very strong sense of what it takes to drive a business" and commend her for her "experience, negotiating ability, and exceptional knowledge base."

Joyce is an active agent working on behalf of franchising in the business community. Through her leadership at the Women's Franchise and Distribution Forum, Women's Foodservice Forum, and Women Corporate Directors Foundation, she has championed women throughout the franchise industry, continuously encouraging women to become multi-unit franchise operators or seek management positions with franchisors. She has served on the boards of the IFA, National Restaurant Association Foundation, Women's Foodservice Forum, ABA Forum on Franchising, The University of North Texas College of Merchandising, Hospitality and Tourism, and the Susan G. Komen for the Cure Advocacy Alliance. She serves

as Chair Emeritus for the Women Corporate Directors' DFW Chapter and as a member of the Advisory Board of National Restaurant Association's Executive Supply Chain Group. She has received numerous awards for her work, including the Women's Foodservice Forum Leadership Award, the IFA Bonnie Levine Award and Compass Award, and the *Dallas Business Journal* Women in Business Award.

A frequent national speaker and writer, Joyce was co-editor of the ABA Forum on Franchising Monograph on Franchise Performance Representations: The New and Updated Earnings Claims, co-author of the Monograph on International Franchising (Local Laws), and co-author of Collateral Issues in Franchising: Beyond Registration and Disclosure (Supply Chain Issues in Franchise Systems), as well as a legal advisor to the first edition of *Franchising For Dummies* (Wiley).

Joyce can be contacted by email at jmzero@gardere.com or by phone at 214-999-4519.

Dedication

This book is dedicated to the franchisors and franchisees that have driven the innovative engine of franchising and from whom I have learned my craft. I wish you continued prosperity.

To Joyce, my co-author, whom I have known and respected for more than 30 years. Collaboration between equals, one primarily with a business background and the other primarily from a legal background, let us explore the same issues through slightly different lenses. The collaboration challenged and benefited our friendship and we hope benefits the reader.

To the leadership and members of the IFA, I am forever grateful for your role in advancing and protecting the business of franchising that has allowed so many people globally to achieve their dreams of economic independence.

To social impact investors, donors, NGOs, and social entrepreneurs, it is my extreme desire that this book trigger a better understanding of the power of social franchising to solve many of the issues we have all been addressing at the base of the pyramid. I want to single out Scott Hillstrom for his leadership in social franchising and Kash Rangan at Harvard University for taking franchising and the base of the pyramid lesson to an entirely new level of understanding.

To my partner Kay Ainsley and the team at MSA Worldwide. It is through you that MSA has achieved its professional standing in franchising. Thank you. Kay Ainsley has been more than my partner and friend. She has been my balance. She has kept me on track, pushed me to succeed, and mentored me for many years. Five-foot

nothing, less than 100 pounds, and a presence that makes senior executives of Fortune 10 companies lean forward as they take notes, Kay is by every measure the most consummate professional and delight I have ever had the good fortune to know.

Finally, to my wife Susan, my children Rachel and Drew, my grandchildren Anabel and David, and my son-in-law Michael, you are what makes life perfect. — Michael

This book is dedicated to my co-author, Michael Seid, without whom I would not have had the opportunity to participate in the writing of this book, and to my treasured partners Len MacPhee, Jess Dance, William Sentell, and S.L. Owens, the driving forces behind this wonderful collaboration known as Gardere's Global Supply Network Industry Practice. I will be forever grateful for your commitment to me and our practice. — Joyce

Author's Acknowledgments

We are grateful to each franchisee and franchisor that has taught us our crafts. We have tried to be good shepherds of their lessons in *Franchise Management For Dummies*. We are also grateful to our many friends and colleagues, including those in the IFA — an immensely important association focused on advancing and protecting franchising — who have contributed in small and large ways to this book.

If it were not for the help of some very talented people at the publisher, most assuredly including our editor Corbin Collins, who kept us focused on removing the normal jargon of industry professionals and driving us to conform to well-established Dummies approaches, this book could never have been written as well as we hope it has.

Publisher's Acknowledgments

Acquisitions Editor: Tracy Boggier

Editor: Corbin Collins

Technical Editor: Charles Cowgill

Production Editor: Siddique Shaik

Producer: Richard Graves

Cover Photos: © Mike Kemp/Getty Images

WILEY END USER LICENSE AGREEMENT

Go to www.wiley.com/go/eula to access Wiley's ebook EULA.