

## 5.6: Franchising- A Popular Trend

### 5. What makes franchising an appropriate form of organization for some types of business, and why does it continue to grow in importance?

When Shep Bostin decided to buy a franchise, he researched the usual suspects: Jiffy Lube, McDonald's, and Quiznos Subs. Bostin, then 38, was a top executive at a dying Gaithersburg, Maryland, technology firm, but instead of becoming another McDonald's franchisee, Bostin chose to remain a geek, albeit one who wheeled around in the signature black PT Cruiser of Geeks On Call, a company that provides on-site computer assistance via a large pool of experienced techies. Bostin made residential and commercial "house calls" for more than a decade as a Geeks On Call franchisee. There are approximately 123 independently owned and operated Geeks On Call franchise territories in 50 states serving over 250,000 customers.<sup>8</sup>

Choosing the right franchise can be challenging. Franchises come in all sizes and demand different skills and qualifications. And with somewhere around 2,500 different franchised businesses in the United States, Bostin had a lot to choose from—from cookie-bouquet peddlers and dog trainers to acupuncture specialists. **Table 4.5** shows the top franchises for 2017 from various sources. *Entrepreneur's* rankings utilize among other factors costs/fees, brand strength, support, and financial strength. *Franchise Business Review* focuses on owner satisfaction, whereas *Franchise Gator* utilizes a formula with factors such as financial stability and engagement.



**Exhibit 4.5** Chance the Rapper was a big winner at the 2017 Grammy Awards. His win was also validation for a new business model. Chance the Rapper does not have a deal with a traditional record label but instead releases his music through streaming services. *How might this approach benefit other aspiring music artists to gain footing and become a force in the music industry?* (Credit: Julio Enriquez/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

Top 10 Franchises for 2017

*Entrepreneur* Top 10

## Top 10 Franchises for 2017

Franchise	Initial investment
1. 7-Eleven Inc.	\$37K to \$1.6M
2. McDonald's	\$1M to \$2.2M
3. Dunkin' Donuts	\$229K to \$1.7M
4. The UPS Store	\$178K to \$403K
5. Jimmy John's Gourmet Sandwiches	\$330K to \$558K
6. Dairy Queen	\$1.1M to \$1.9M
7. Ace Hardware Corp.	\$273K to \$1.6M
8. Wingstop Restaurant Inc.	\$303K to \$923K
9. Sport Clips	\$189K to \$355K
10. RE/MAX LLC	\$38K to \$224K

## Franchise Business Review Top 10

Franchise Name/ Industry	Minimum Investment
Visiting Angels (Senior care)	\$77,985
MaidPro (Cleaning and maintenance)	\$74,560
Pinot's Palette (Sports and recreation)	\$63,400
Christian Brothers Automotive (Automotive)	\$146,693
Home Instead Senior Care (Senior care)	\$463,698
Our Town America (Advertising and Sales)	\$115,000
FASTSIGNS (Business services)	\$63,300
Sandler Training (Business services)	\$182,329
Soccer Shots ((Child services)	\$88,150
Two Men and a Truck (Services)	\$36,000

## Franchise Gator Top 10

Franchise Name	Minimum Cash Required
Fast Signs	\$100,000
Tropical Smoothie Cafe	\$100,000
Marco's Pizza	\$100,000
Zoup	\$100,000
Mathnasium	\$100,000
Christian Brothers Automotive	\$80,000
Two Men and a Truck	\$150,000
Kiddie Academy	\$200,000
Wild Birds Unlimited	\$40,000
SportClips	\$200,000

**Table 4.5** Sources: “2017 Franchise 500 Ranking, Franchise 500 2017,” <https://www.entrepreneur.com/franchise500> (August 17, 2017); “Top Franchise Opportunities for 2017,” Franchise Business Review, [topfranchises.franchisebusinessreview.com/](http://topfranchises.franchisebusinessreview.com/), (August 17, 2017); “Top 100 Franchises of 2017,” Franchise Gator, <https://www.franchisegator.com/lists/top-100/>, (August 17, 2017).

Chances are you recognize some of the names listed in **Table 4.5** and deal with franchise systems in your neighborhood every day. When you have lunch at **Taco Bell** or Jamba Juice, make copies at FedEx Office, change your oil at Jiffy Lube, buy candles at Wicks 'n' Sticks, or mail a package at The UPS Store, you are dealing with a franchised business. These and other familiar name brands mean quality, consistency, and value to consumers. Franchised businesses provided about 8.9 million direct jobs with a \$890 billion economic output for the U.S. economy.<sup>9</sup>

**Franchising** is a form of business organization that involves a **franchisor**, the company supplying the product or service concept, and the **franchisee**, the individual or company selling the goods or services in a certain geographic area. The franchisee buys a package that includes a proven product or service, proven operating methods, and training in managing the business. Offering a way to own a business without starting it from scratch and to expand operations quickly into new geographic areas with limited capital investment, franchising is one of the fastest growing segments of the economy. If you are interested in franchising, food companies represent the largest number of franchises.

A **franchise agreement** is a contract that allows the franchisee to use the franchisor's business name, trademark, and logo. The agreement also outlines rules for running the franchise, services provided by the franchisor, and financial terms. The franchisee agrees to follow the franchisor's operating rules by keeping inventory at certain levels, buying a standard equipment package, keeping up sales and service levels, taking part in franchisor promotions, and maintaining a relationship with the franchisor. In return, the franchisor provides the use of a proven company name and symbols, help in finding a site, building plans, guidance and training, management assistance, managerial and accounting systems and procedures, employee training, wholesale prices for supplies, and financial assistance.

## Advantages of Franchises

Like other forms of business organization, franchising offers some distinct advantages:

- *Increased ability for franchisor to expand.* Because franchisees finance their own units, franchisors can grow without making a major investment.
- *Recognized name, product, and operating concept.* Consumers know they can depend on products from franchises such as Pizza Hut, Hertz, and Holiday Inn. As a result, the franchisee's risk is reduced and the opportunity for success increased. The franchisee gets a widely known and accepted business with a proven track record, as well as operating procedures, standard goods and services, and national advertising.
- *Management training and assistance.* The franchisor provides a structured training program that gives the new franchisee a crash course in how to start and operate their business. Ongoing training programs for managers and employees are another plus. In addition, franchisees have a peer group for support and sharing ideas.
- *Financial assistance.* Being linked to a nationally known company can help a franchisee obtain funds from a lender. Also, the franchisor typically gives the franchisee advice on financial management, referrals to lenders, and help in preparing loan applications. Many franchisors also offer short-term credit for buying supplies, payment plans, and loans to purchase real estate and equipment. Although franchisors give up a share of profits to their franchisees, they receive ongoing revenues in the form of royalty payments.



**Exhibit 4.6** Countless franchise opportunities exist for entrepreneurs with access to start-up capital. Despite the broad range of franchise opportunities available, lists of the fastest-growing franchises are heavily weighted with restaurant chains and cleaning services. Start-up costs for a Quiznos franchise can be pricey; expenses associated with opening a Club Pilates franchise or a Visiting Angels adult care service are significantly lower. *How do entrepreneurs evaluate which franchising opportunity is right for them?* (Credit: Mr. Blue Mau Mau/ Flickr/ Attribution 2.0 Generic (CC BY 2.0))

## Disadvantages of Franchises

Franchising also has some disadvantages:

- **Loss of control.** The franchisor has to give up some control over operations and has less control over its franchisees than over company employees.
- **Cost of franchising.** Franchising can be a costly form of business. Costs will vary depending on the type of business and may include expensive facilities and equipment. The franchisee also pays fees and/or royalties, which are usually tied to a percentage of sales. Fees for national and local advertising and management advice may add to a franchisee's ongoing costs.
- **Restricted operating freedom.** The franchisee agrees to conform to the franchisor's operating rules and facilities design, as well as inventory and supply standards. Some franchises require franchisees to purchase from only the franchisor or approved suppliers. The franchisor may also restrict the franchisee's territory or site, which could limit growth. Failure to conform to franchisor policies could mean the loss of the franchise.

## Franchise Growth

Many of today's major franchise brands, such as McDonald's and KFC, started in the 1950s. Through the 1960s and 1970s, many more types of businesses—clothing, convenience stores, business services, and many others—used franchising to distribute their goods and services. Growth comes from expansion of established franchises—for example, Subway, Pizza Hut, and OrangeTheory Fitness—as well as new entrants such as those identified by *Entrepreneur* and *Franchise Gator* among other sources. According to *Entrepreneur* magazine, the top three new franchises in 2017 are (1) Mosquito Joe, (2) Blaze Fast-Fire'd Pizza, and (3) uBreakiFix, whereas according to *Franchise Gator*, the top three new franchises in 2017 are (1) Mosquito Joe, (2) Digital Doc, and (3) Nurse

Next Door Home Healthcare Services. On both rankings, Mosquito Joe ranks at the top. Mosquito Joe provides mosquito control treatment services for both residential and commercial clients.<sup>10</sup>

Changing demographics drive franchise industry growth, in terms of who, how, and what experiences the most rapid growth. The continuing growth and popularity of technology and personal computing is responsible for the rapidly multiplying number of eBay drop-off stores, and tech consultants such as Geeks on Call are in greater demand than ever. Other growth franchise industries are the specialty coffee market, children's enrichment and tutoring programs, senior care, weight control, and fitness franchises.

## The Next Big Thing in Franchising

All around you, people are talking about the next big thing—Subway is the new miracle weight-loss solution, the workout at OrangeTheory Fitness is the answer to America's fitness needs—and you are ready to take the plunge and buy a trendy franchise. But consumers' desires can change with the tide, so how do you plan an entrance—and exit—strategy when purchasing a franchise that's a big hit today but could be old news by tomorrow? **Table 4.6** outlines some tips on purchasing a franchise.

### International Franchising

Like other forms of business, franchising is part of our global marketplace economy. As international demand for all types of goods and services grows, most franchise systems are already operating internationally or planning to expand overseas. Restaurants, hotels, business services, educational products, car rentals, and nonfood retail stores are popular international franchises.

Franchisors in foreign countries face many of the same problems as other firms doing business abroad. In addition to tracking markets and currency changes, franchisors must understand local culture, language differences, and the political environment. Franchisors in foreign countries also face the challenge of aligning their business operations with the goals of their franchisees, who may be located half a globe away.

#### Tips for Purchasing a Franchise

1. Take a personality test to determine the traits that will help and hurt you and assess your strengths and weaknesses.
2. Do your research about the franchise company, its services, and your potential location, and study the field.
3. Seek assistance from tax advisors and contract specialists.
4. Focus on financials: count your money, limit liability with appropriate business structure, and look beyond.
5. Beware of franchise consultants.
6. Use the franchise disclosure document to ensure everything is clear.
7. Utilize your instincts, and follow your gut.

**Table 4.6** Sources: "12 Things To Do Before You Buy a Franchise," *Forbes*, <https://www.forbes.com>, June 22, 2016; U.S. Small Business Administration, "6 Franchise Purchasing Tips," <https://www.sba.gov>, August 19, 2014; "5 Tips for Buying a Franchise," *Small Business Trends*, smalltrends.com, January 29, 2013.

## Is Franchising in Your Future?

Are you ready to be a franchisee? Before taking the plunge, ask yourself some searching questions: Are you excited about a specific franchise concept? Are you willing to work hard and put in long hours? Do you have the necessary financial resources? Do you have prior business experience? Do your expectations and personal goals match the franchisor's?

Qualities that rank high on franchisors' lists are passion about the franchise concept, desire to be your own boss, willingness to make a substantial time commitment, assertiveness, optimism, patience, and integrity. Prior business experience is also a definite plus, and some franchisors prefer or require experience in their field.

## EXPANDING AROUND THE GLOBE

### Setting Up (Sandwich) Shop in China

Lured by China's fast-food industry, estimated today at \$180 billion, Jim Bryant, 50, was not the only entrepreneur to discover it is hard to do business in China. In ten years, Bryant has opened 19 Subway stores in Beijing—only half the number he was supposed to have by now—while other companies such as Chili's and Dunkin' Donuts have given up their Chinese operations altogether.

Subway, or Sai Bei Wei (Mandarin for "tastes better than others"), is now the third-largest U.S. fast-food chain in China, right behind McDonald's and KFC, and all its stores are profitable. Although Bryant had never eaten a Subway sandwich before, Jana

Brands, the company Bryant worked for in China, sold \$20 million in crab to Subway annually, so he knew it was big business. When Subway founder Fred DeLuca visited Beijing in 1994, Bryant took him to a place not on the official tour: McDonald's. It was Sunday night, and the place was packed. "We could open 20,000 Subways here and not scratch the surface," Bryant remembers DeLuca saying.

Two weeks later, Bryant called Subway's headquarters in Milford, Connecticut, and asked to be the company representative in China. He would recruit local entrepreneurs, train them to become franchisees, and act as a liaison between them and the company. He would receive half the initial \$10,000 franchise fee and one-third of their 8 percent royalty fees. He could also open his own Subway restaurants. Steve Forman, the founder of Jana Brands, invested \$1 million in return for a 75 percent stake.

All foreign businesses in China had to be joint ventures with local partners, so Bryant used the Chinese business practice of relying on local relationships to find a manager for his first restaurant in Beijing. The project ran into problems immediately. Work on the store was delayed, and construction costs soared. It didn't take Bryant long to realize that he and Forman had been swindled out of \$200,000.

When it finally opened, the restaurant was a hit among Americans in Beijing, but the locals weren't sure what to make of it. They didn't know how to order and didn't like the idea of touching their food, so they held the sandwich vertically, peeled off the paper, and ate it like a banana. Most of all, the Chinese didn't seem to want sandwiches.

But Subway did little to alter its menu—something that still irks some Chinese franchisees. "Subway should have at least one item tailored to Chinese tastes to show they respect local culture," says Luo Bing Ling, a Beijing franchisee. Bryant thinks that with time, sandwiches will catch on in China. Maybe he's right: Tuna salad, which he couldn't give away at first, is now the number one seller. Today there are nearly 600 Subway stores in China, with China's fast-food industry estimated at over \$180 billion.

#### Critical Thinking Questions

1. What are some of the main problems U.S. franchisors encounter when attempting to expand their business in a country such as China?
2. What steps can franchisors take to ensure a smooth and successful launch of a new franchise business in a foreign country?

Sources: Subway, "Explore Our World," [www.subway.com](http://www.subway.com), accessed April 2, 2018; "Sales Revenue in Fast Food Restaurants in China 2011–2018," *Statista*, <https://www.statista.com>, accessed April 2, 2018; Carlye Adler, "How China Eats a Sandwich," *Fortune*, March 21, 2005, p. F210-B; Julie Bennett, "Chinese Market Offers Franchise Challenges," *Startup Journal—The Wall Street Journal Online*, <http://www.startupjournal.com>.

So what can you do to prepare when considering the purchase of a franchise? When evaluating franchise opportunities, professional guidance can prevent expensive mistakes, so interview advisers to find those that are right for you. Selecting an attorney with franchise experience will hasten the review of your franchise agreement. Getting to know your banker will speed up the loan process if you plan to finance your purchase with a bank loan, so stop by and introduce yourself. The proper real estate is a critical component for a successful retail franchise, so establish a relationship with a commercial real estate broker to begin scouting locations. Doing your homework can spell the difference between success and failure, and some early preparation can help lay the groundwork for the successful launch of your franchised business.

If the franchise route to business ownership seems right for you, begin educating yourself on the franchise process by investigating various franchise opportunities. You should research a franchise company thoroughly before making any financial commitment. Once you've narrowed your choices, ask for the *Uniform Franchise Offering Circular (UFOC)* for that franchisor, and read it thoroughly. The Federal Trade Commission (FTC) requires franchisors to prepare this document, which provides a wealth of information about the franchisor, including its history, operating style, management, past or pending litigation, the franchisee's financial obligations, and any restrictions on the sale of units. Interviewing current and past franchisees is another essential step. And most franchise systems use computers, so if you are not computer literate, take a class in the basics.

Would-be franchisees should also check recent issues of small-business magazines such as *Entrepreneur, Inc.*, *Startups*, and *Success* for industry trends, ideas on promising franchise opportunities, and advice on how to choose and run a franchise. The International Franchise Association website at <http://www.franchise.org> has links to *Franchising World* and other useful sites. (For other franchise-related sites, see the "Working the Net" questions.)

## CONCEPT CHECK

1. Describe franchising and the main parties to the transaction.
2. Summarize the major advantages and disadvantages of franchising.
3. Why has franchising proved so popular?

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