PITCHER PARTNERS

The 5 myths of franchising

Your guide to avoiding common franchising mistakes

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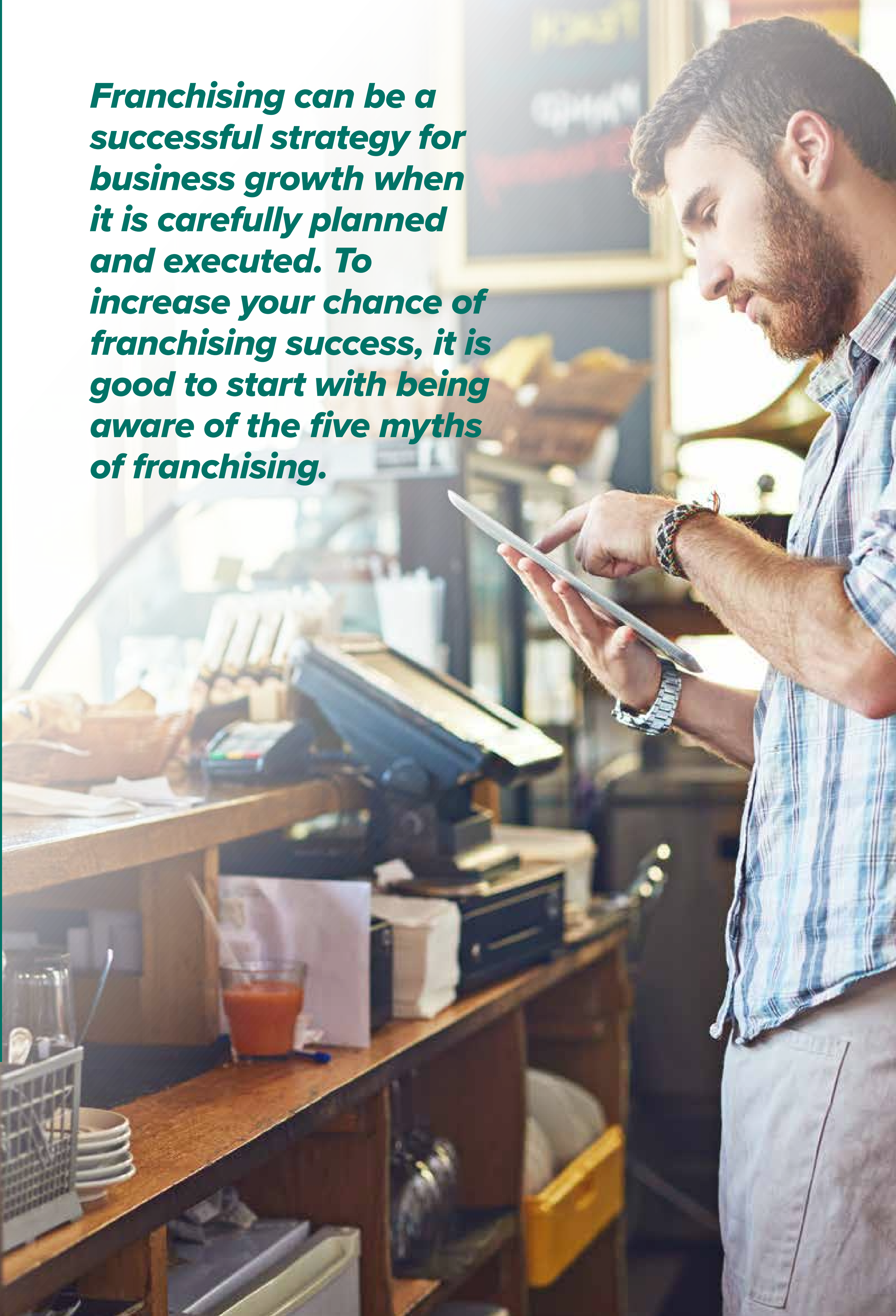
Franchising can be a successful strategy for business growth when it is carefully planned and executed. To increase your chance of franchising success, it is good to start with being aware of the five myths of franchising.



1. One-size fits all

One of the biggest mistakes emerging franchisors make is to replicate the model and fee structures of a similar business. This shows limited consideration of how different fees can impact the business. A successful franchise strategy for one franchise operation does not necessarily mean it will work for yours. Copycat royalties may not be viable for the revenue a franchisee can achieve, or the amount required by the franchisor to build a sustainable business.

Limitations in the financial structure of franchise models can take time to become apparent. For example, the financial impact of growing stores and adding appropriate support costs may not be realised until you have already added multiple sites. Franchise models must be developed with the individual business in mind, with consideration given to the commercial viability of both the franchisor and franchisees at various fee levels and business performance.

The example below highlights how a 'one-size fits all' royalty approach to these four burger businesses produces very different outcomes for a franchisee:

	Bob's Burgers	***Penny's Patties***	***Sophie's Sliders***	***Wazza's Whoppers***
Income				
Sales Prices ($)	8	10	12	14
Sales Volume (#)	750	500	350	400
Total Sales ($)	***6,000***	***5,000***	***4,200***	***5,600***
Expenses				
Cost of Goods Sold ($)	1,980	1,800	1,680	2,520
Gross Margin ($)	4,020	3,200	2,520	3,080
Royalty (%) of Sales	***8%***	***8%***	***8%***	***8%***
Royalty ($)	480	400	336	448
Other Expenses ($)	2,000	2,250	2,500	2,500
Profit ($)	***1,540***	***550***	***(316)***	***132***
Profit (%) of Sales	26%	11%	**(8%)**	2%

Overlaying this with the franchisor's position also shows the importance of understanding the implications of each businesses structure.

Income				
Franchisees (#)	10	10	10	10
Royalties ($)	480	400	336	448
Royalty Income	***4,800***	***4,000***	***3,360***	***4,480***
Expenses				
Support Costs ($)	4,500	4,200	2,000	1,000
Profit ($)	***300***	***(200)***	***1,360***	***3,480***

2. Franchisors make their money from initial franchise fees

Franchising is not a strategy to make a quick dollar from upfront franchise fees while leaving your franchisees to fend for themselves. The number one priority must be to support and promote franchisees' success over time, which will subsequently build the profitability of the franchisor. It is fundamentally a model that only works if both sides are acting for mutual benefit.

The initial franchise fee mostly acts a cost recovery tool for the expenses of developing your franchise system, recruiting and training franchisees. At some point the number of new franchises granted will begin to reduce and coincidentally your reliance on ongoing royalties for sustainability will increase. It is this ongoing royalty from franchisees that will be the basis for the franchisor's long-term sustainability. Ultimately when it comes time for you to sell the entire franchise business, the recurring revenue you receive from royalties will be viewed more favourably than one-off franchise fees.

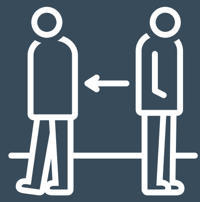
3. Franchising is a turnaround strategy

Franchising has been mistakenly linked with turning underperforming businesses into overnight success stories and making immediate financial return. If there are fundamental risks with the business model, franchising is not a strategy that can overturn these. The business must be viable in its own right before successful growth can be achieved. Some of the key risks in the business model include:

- an over-reliance on the owner
- limited investment into systems and efficiencies
- tight profit margins
- no thought to online or digital
- declining sales
- costs not closely managed
- competitors offering a more appealing value proposition
- huge discrepancies in multi-site performance
- high staff turnover
- consistently negative customer feedback
- long turnover time for stock

If these challenges exist in the business model, they must first be resolved before you can focus on strategies to profitably replicate the business. A franchisee will then have a robust blueprint to follow to achieve their own success.

4. Franchisors can 'set and forget'



Some business owners implement the franchise model and leave it to evolve, in the mistaken belief they can relax and watch the profits flow. However, signing new franchisees is just the beginning. You now have a leadership responsibility to be at the forefront of your industry and support franchisees in their endeavours, whilst operating a sustainable business. This requires emerging thinking, investment in new systems and growing a supportive head office culture.

Franchisees who struggle to perform well often have head offices who have under-invested and have failed to create a positive franchising culture. This can include not being highly selective in franchisee recruitment, failing to implement robust processes, or a lack of ongoing franchisee advice such as benchmarking and business improvement initiatives. Where head office is remote and 'hands-off', the result is often inconsistent customer experience and damage to brand reputation. The best franchise networks leverage data and give franchisees the intelligence and collaborative tools to improve their business. They also have coaching and development based support structures (rather than a compliance/audit focus) to encourage franchisee success.

5. Off-the-shelf legal agreements will suffice

Franchisors who do not have their legal agreements developed by franchise specialist lawyers may risk having terms which relate to completely different business models. The long-term impacts of a poorly created Franchise Agreement can be irreversible, with franchisees locked into long term contracts.

Franchising has its own code which needs to be thoroughly understood by your lawyer when they are creating the Franchise Agreement and any other required documentation. A 'find and replace' document may minimise your costs in the short term, but may not support you should a disgruntled franchisee raise a challenge.
The franchise legal documents must be customised to your business' individual circumstances. Issues such as territories, core products or services, preferred suppliers, leasing arrangements, renewal options, social media protocols and online sales can ruin the business you have built if they are not documented correctly. These documents must also align with your use of the Franchise Operations Manual.

Is your business ready to franchise?

Pitcher Partners' team of specialists can help you identify if your business is ready to franchise (or alternatively identify what the best growth option is for you). Get in touch for a free assessment to determine the best method to grow your business.

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