

Franchising: A Cookie-Cutter Approach to Growing Your Business

Enrique C. Brito, CFA, AVA, CM&A

Franchising has proven to be a very successful business growth strategy. The International Franchise Association (IFA) reports that there are currently about 2,500 franchises in the U.S. representing more than 534,000 franchise units. Moreover, franchising is estimated to be growing at 10% to 12% annually.

The franchise concept is highly appealing, not only to entrepreneurs seeking to ex-



expand a successful business model, but also to those who are looking for the next career challenge or who are dissatisfied with their current job and are thinking about starting their own businesses. But, as will be briefly explored in this article, franchising is a process that requires careful planning for franchisor and franchisee alike.

It is important to note, however, that the process of evaluating a business model as a potential franchise opportunity has a significant unintended consequence. For entrepreneurs, it forces them to critically evaluate the soundness of their operating and distribution systems as well as their branding strategies. For prospective franchisees, the process of evaluating whether or not a franchise makes business sense, forces them to reflect critically and strategically on what makes a business successful. Thus, regard-

less of whether or not they end up engaged in franchising, both sides are likely to derive important insights.

For the entrepreneur, working on a business as though it were to be franchised can provide important advantages. First, there is the need to create systems around marketing, operations and distribution—three key business functions that correlate closely with business success. Next, these practices must be documented to institutionalize the customer experience. In addition, there is the need to continuously focus on brand building to position and differentiate the business' products and services. Ultimately, this process improves the consistency in the business operations which in turn builds customer loyalty and business value.

As commonly defined, a franchise is a network of independent operators doing business under a common brand, a successful method of operation and proven marketing and distribution systems. But, in addition to these elements, a franchise has two other features: ongoing support and ongoing fees. And, as every franchisor and franchisee can attest, each of these elements present both challenges and opportunities.

Operating under one common brand provides franchisees with instant recognition and the ability to build a customer base rapidly, but only as long as they stay true to the brand and do not introduce extraneous elements into the original concept. Proven marketing and distribution systems also give franchisees a head start, but they require strict adherence to the systems to attract and

keep customers. In addition, ongoing support is critical as franchisees require continuous help with running the systems of the business.

For the franchisor, the focus should be on delivering training programs that convey the operational knowledge required to successfully run the business as well as general training in human resources, basic accounting and business management.

Lastly, there is the issue of fees. In addition to the initial franchise fee covering a franchisee's right to use the name, systems and manuals, there is a royalty (ongoing) fee whose purpose is to cover the ongoing support that the franchisor provides.

In terms of their evolution, most franchises go through four well-define growth stages: conceptual, prototype, developmental and expansion. In the conceptual stage, the entrepreneur comes up with a novel product/service idea or simply finds a way to improve on an existing business model. This idea is then tested in the prototype stage by setting up one or more units to deliver the products or services to the customer. Once the prototype stage has been successfully completed and the operating, marketing and distribution systems have been tested and documented, the developmental stage begins. In this third stage, the entrepreneur's focus is on establishing their first 10-20 units by finding suitable operators as new franchisees. The developmental stage is followed by the expansion stage in which the objective is to grow beyond the first 20 franchise operations.

The operational risk in a franchise model resides primarily in the first three stages. Once the first 10-20 units are operating successfully, it is likely that the experience gained by the franchisor will make it more

likely that the franchise will thrive. But, as with any business enterprise, the franchise's long term survival will depend on the robustness of its systems, the quality of its franchisees, the level of its ongoing operational support and the adherence to the brand (not to mention the entrance of new competitors).

Expanding a business through a franchise strategy comes with many inherent challenges such as maintaining the integrity of the brand, providing continuing support for franchisees and finding the right people who will enhance the business concept. However, just the process of preparing for the future implantation of such strategy, in terms of evaluating and documenting your operating, marketing and distributions systems, will position your business for solid growth no matter what path you end up choosing

About the Author: Enrique C. Brito is a partner and senior managing director of The Mclean Group, a national investment bank providing merger and acquisition, valuation and private equity financing services. He has over 17 years of corporate finance and investment banking experience and lectures nationally on the subjects of M&A and business valuation. He can be reached via e-mail at ebrito@mcleanllc.com or call 703-827-5093.