SO YOU WANT TO START A FRANCHISE?

Here are the pros and cons, plus advice from experts for deciding whether a franchise business is right for you.

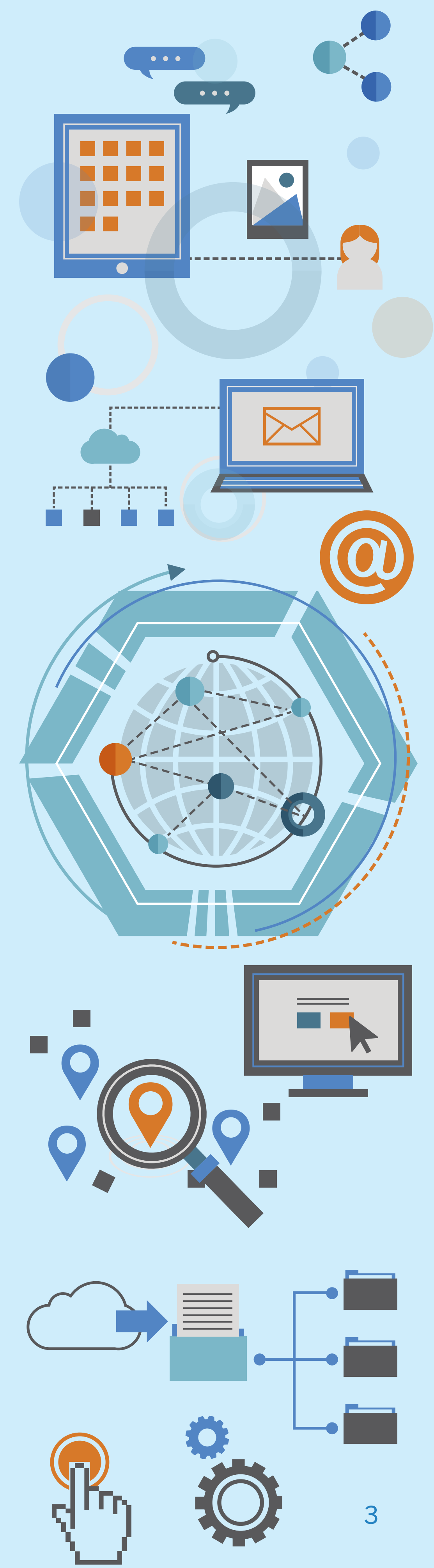
INTRODUCTION

Nearly 4 million Americans left their jobs in April 2021. According to the Bureau of Labor Statistics data — an unprecedented number in the two decades the government has been tracking this data, pushing the quit rate 24% higher than it was before the pandemic.[1]

It's unclear what the next steps might be for these workers, but it's safe to say many might consider launching their own business or buying a franchise. In fact, according to the International Franchise Association, franchising is projected to open more than 26,000 locations, add nearly 800,000 new jobs, and contribute $477 billion to the U.S. GDP. If you are one of the many considering whether the next move is to open a franchise, here are the pros and cons, plus advice from those who've been there.

1 https://www.cbsnews.com/news/workers-quitting-jobs-record-rate-economy/

According to Franchise Business Review, there are currently 28,000 franchise owners across more than 300 of today's leading franchise companies.



What is a Franchise?

Franchising is a business structure that allows business owners to buy into an established brand and operate a business rather than develop their own original idea.[1] Franchises are often referred to as chains and are a popular model in the restaurant industry. But they can span any sector, including clothing, petroleum retail, tax and financial services, healthcare services, cleaning and janitorial services, and insurance. Franchising can be an attractive way to become an entrepreneur because it may seem a less risky or time-consuming approach. But those with experience offer a word of advice.

"You have to go in with your eyes wide open," said Deanna Wesley, a successful owner/operator with more than 20 years' experience running a Culver's restaurant franchise. "In the beginning, I worked 80 hours or more a week for months, 7 days a week. You need to be willing to put the time in to make it work. It takes a long time to become profitable, so you have to be prepared financially. And you have to love what you do."

2 https://smallbusiness.chron.com/four-types-franchising-12982.html

Why Consider a Franchise?

Launching a business of any type takes tremendous effort. The benefits of considering a franchise include its ability to provide:

- **Brand recognition** – Building and establishing a brand requires extensive marketing and expense. With a franchise, you have the advantage of all the work that has been done before you – provided you understand the company's commitment and willingness to evolve and invest in future programs, tools, and technologies to maintain or grow brand awareness.
- **Guidance and structure** – Franchises typically come with a clear set of rules and expectations, designed to ensure continued success. This can shorten the path to success.
- **Quality control and consistency** – For consumers, one key reason to frequent a franchise is knowing what to expect in terms of products, services, and experience. But it also makes it easier for you as a potential owner/operator to understand what you need to deliver to customers consistently.

The Downside of Franchising

Of course, there are some downsides to franchising, which include:

- **High start-up costs and occasionally "hidden" fees.** Costs may include not only the start-up fees but also expenses for materials or products (such as the need to buy ketchup packs through HQ) or required renovations after a certain time period or the need to comply with rebranding initiatives, such as installing new signage and product packaging.
- **Long-term contracts** that lock you into your initial licensing agreement for 15 years, with 10-year renewal terms that follow.
- **Less flexibility and control.** While a benefit of becoming a franchisee is having well-established rules and guidelines, they may also eliminate your ability to make certain business decisions or deploy innovative ideas.
- **Association with the brand.** Again, a benefit of the franchise model is being able to ride the coattails of brand recognition. That can be a challenge, however, if there are corporate scandals or crises, such as a data security breach, that put the business in a vulnerable position. Additionally, if the brand does not invest in itself to meet shifting customer expectations – particularly when it comes to the digital experience – it can lose customers and market share and be forced to close locations.

Types of Franchisees

One franchise consultant with more than 25 years' experience, explained that she generally sees three types of potential franchisees:

1. **Active owners** – who will be deeply involved in day-to-day operations and all aspects of running the business.
2. **Semi-absentee owners** – who are looking to own it as a side business which will provide them with a supplementary revenue stream. They may spend 10 to 15 hours a week on the business.
3. **Passive owners** – who are simply buying businesses to add them to their portfolio and who will hire people to run the operations.

As a franchise consultant, she serves as a matchmaker of sorts, helping potential business owners understand their strengths and interests and then identify not only which franchises might be the right fit but also how a person's skillsets can best be applied.

"People kind of understand who they are," she said. "They'll say, 'I don't like sales,' for example. If that's the case and they're more of an operations person, they'll want to look for franchises that are acquiring customers and doing the selling."

It's also smart, she said, to look for the business opportunities that align with your past experience. In other words, if you've been in retail fashion, it might be a steep climb to transition to the restaurant and food service industry.

10 Tips for Getting Started

Here, the experts outline 10 tips for getting started.

1. Take a compatibility test.

The first step, if you are unsure which type of franchise to explore, is to take one of the many online tests designed to uncover sectors that might be a good match. That's how Lynn Loignon began her search. After years as a communications executive at a major retailer and two decades watching her sister run a successful franchise, Ms. Loignon decided to consider becoming a franchisee herself. She conducted extensive online research into a variety of businesses and completed several compatibility surveys. She noted that while they can be helpful, they also generate leads for franchise consultants, so you need to realize you'll receive multiple follow-up emails and promotions.

2. Count your money.

Prior to moving too far down the road, consider the investment you can and are willing to make and where that money will come from. Will you need loans? If not, what sources of cash do you have? In addition to start-up costs, you will likely need money to support yourself while you are in the initial stages of training and setting up the business. For example, if it takes eight months of construction to build out your brick-and-mortar location and go through management training, how will you fund your daily living expenses?

3. If you need help, hire a franchise consultant.

If you know the exact type of franchise you're looking for, you can narrow down your options and contact their headquarters directly. But if you are unsure, you can turn to an objective consultant. They can help you understand your budget and how you will pay expenses; explore what you're looking for and assist with finding financing or lending partners. Franchise consultants work on behalf of their clients free of charge and are compensated by the industry.

4. Understand the process.

Exploring franchise opportunities is a lengthy process. And it's not simply you as a candidate doing research and making decisions. The franchisor is also considering whether you have what it takes to be successful.

"I didn't realize how franchisors have really high standards," explained Ms. Loignon. "The process begins with an application, and you provide a lot of information, even personal financial details. They want to see who you are, whether you have the experience and the money to bring you into the franchise. They were trying to decide if I had the prowess to successfully run their business within their framework."

5. Learn the franchise registration rules – by state.

There are up to 15 "registration states" which require franchises to register their operations. Each of those 15 have their own rules and requirements. Since it is a highly regulated industry, there are big implications and penalties if processes are not followed properly. In some cases, franchisors won't even entertain speaking with a new potential owner/operator if they're located in a highly restrictive state. It may not be worth the hassle to expand in that area based on their target demographics and business strategy.

6. Do your research.

Ms. Loignon spent considerable time researching several franchise operations. Consequently, she said, “I learned that not every franchise owner is honest or has integrity. There are very strict guidelines for franchisors. They cannot tell you that you’re going to make “X” amount of money or promise profitability.”

But you can meet with franchisees and ask questions. At one point, the franchisor provided Ms. Loignon with a spreadsheet and instructions for calculating potential sales. But in her due diligence, she learned how misleading those calculations were.

During your assessments, also consider issues related to brand strength and the customer experience. Are there programs in place to support good employee training? Is the customer experience in fact valued and branded? Is there infrastructure to support the digital experience, which is increasingly in demand by customers? And, how progressive does the home office seem to be in terms of rolling out digital tools and technologies to support both employees and customer engagement?

7. Talk to franchisees and ask hard questions.

Ms. Loignon was able to uncover important details by talking directly with franchisees. Initially, she noticed that the contact list of franchisees provided to her included only new owners who had recently opened or were in the process of opening. She wanted to speak to owners who had been around a while or opened multiple locations.

“When speaking with current owners, some reported they had been open for 5 years and hadn’t made a penny. Yet the franchisor would not let people out of their contracts.”

“I asked some hard questions. I wanted to make sure I really understood everything before I went forward. Some weren’t willing to share. They were a bit fearful. Some were so angry and frustrated; they were willing to tell me everything. The more I spoke with people, the more I learned. Some were in tears because they had lost everything,” she recalled.

“Thank goodness I figured it out. I was so excited because I’d found a location. It looked reasonable to hit the numbers. I had dreams of expanding. But what I discovered is that it was all about the franchisor making money, not supporting their owners.”

Revenue and profit aren’t the only hot topics to explore. It’s also important to understand the corporate infrastructure, and the types of networking, tools (like digital signage), and cloud or premise-based applications it relies on day to day. This doesn’t mean you need to understand IT lingo or all the specifics, but it is useful to learn the brand’s approach to technology, especially given its importance in operations and delivering the customer experience. As one small example, if you’re considering a retail franchise, find out if compliance with Payment Card Industry (PCI) data security standards is left up to individual franchisees or if HQ provides support such as guidance or network monitoring solutions. Data breaches are a quick way to rack up fines and penalties and tarnish a brand.

8. Read the entire Financial Disclosure Document.

In addition to contacting franchisees directly, all three experts stressed the importance of reading the Financial Disclosure Document (FDD). *Entrepreneur Magazine* explains that the FDD includes 23 standardized sections to break down all associated costs, obligations, restrictions, regulations, and benefits that come with the investment in a specific franchise. The FDD, which is required by the Federal Trade Commission (FTC), is designed to make it easier for candidates to compare one franchise opportunity against others. Typically, you won't gain access to the FDD until you're fairly far along in the vetting process.

Experts advised that whenever that time comes, read every word within the 200-250 page document. And be sure to look for Item 19, which is where franchisors show off exactly how profitable or unprofitable their franchise could be. Also, look for long-tenured brands, with hundreds of units open, and be sure to understand their model. While some people think emerging brands are more exciting, they also carry more risk. One additional option is to hire a franchise attorney to review the documents prior to signing.

9. Understand the timeline.

Selecting and buying a franchise is a lengthy "courting" process that can last up to a year or more. That's just to get to the point where you're signing a licensing agreement. Then, you'll need to attend training, hire staff, and build out your space. It's good to understand all that's involved and to prepare yourself for tasks taking longer than expected.

10. Be realistic.

Perhaps the greatest advice the experts shared was to go into the process with eyes wide open.

"Most people are choosing a franchise because they want to be independent and own their own business," Ms. Loignon said. "The irony is, if you lose it all, you are going to have to go back to working for someone else. You may have blown through all your savings and be carrying significant debt."

For that reason alone, even if you love everything you've learned about the brand and the way the business operates, be patient and realistic. Make the smartest business decision you can. Hopefully, it will be your first of many.

Questions You Should Ask

When researching any franchisor, be sure to ask these questions:

- How did the franchise begin? (Was it family owned and operated?)
- How fast did it expand? How long has it been a franchise operation?
- What does the training program look like and how long does it last? (Will you be able to support yourself through that period?)
- What type of employee training is offered to support a branded experience?
- What types of networked systems and processes exist? Are they efficient or outdated?
- Does the brand embrace innovative solutions or technologies to support franchisees, employees, and the customer experience?
- How well did the franchise pivot in response to the pandemic? Was it able to respond quickly?
- What type of support can you expect? (Are there free classes? Will they pay for convention attendance?)
- What is the size of a territory? (You may be granted three protected miles for example. In service franchising, protected territories may be based on number of households, population and income levels.)
- What prompts a default by an owner? What if an owner isn't doing well, can they force a shutdown?
- What are the renewal requirements?
- How many locations have closed and after how long did closures occur?
- Do they have a mentorship program?
- What are the renewal requirements? Is there a renewal fee? And if so, how much?

For additional information, please call 1-888-440-7126 or visit www.hughes.com.

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