

Business Financing Network

Franchising: A Business Success Model

By Alan Kenyon

Franchising can be a very good business model for new entrepreneurs. Franchises can be especially attractive for those new to business and who want quick, predictable results with minimal uncertainties. This article explores a few of the reasons franchising often should be the business model of choice--especially for entrepreneurs also considering independent startup businesses.

Increased Probability of Success

Entrepreneurs comparing new independent ventures or acquiring franchises should reflect on the government's sobering statistics regarding the two business models. Agencies like the Small Business Administration and the U.S. Department of Commerce usually agree that only about one out of five independent startup businesses are still operating after ten years. That means roughly 80% on new startup ventures do not celebrate their tenth anniversaries.

The figures for franchising are equally noteworthy—although in a positive vein. Industry experts estimate that 90% of franchise outlets still are in business after ten years of operations.

Note however, the franchise success figure generally is believed to pertain to the actual units and not necessarily the original owners. In addition, it is very common for successful franchisees to own more than one unit. Nevertheless, analysts agree that the chances of success are many times greater for new franchise owners than for proprietors of independent startup ventures.

Market Share

A major reason for the success of franchising is that they dominate their markets. There are an estimated 2000-3,000 franchise companies in the United States, spanning over 70 different industries. A new franchise opens in the United States every eight minutes.

Analysts estimate that franchises represent only about 8% of the total service and retail business outlets in the United States. Yet, they capture close to 50% of the total dollars spent in those markets.

Cost Factors

Aspiring entrepreneurs sometimes believe franchises “cost too much.” They view the initial franchise fees and ongoing royalties as excessive and feel they are windfalls for the franchisors. In reality, the costs of joining franchise systems can represent very good deals for franchisees.

There are two basic costs of going into franchising: (1) the initial franchise fees and expenses of starting the business, and (2) ongoing fees and royalties. Consider why they can represent good values.

Initial Fees

All franchises require an initial fee. In return, franchisees acquire:

- proven business models
- intense training that rapidly makes new owners the “best” in their respective industries (enabling rapid career transitions)
- site selection, lease negotiation, and build-out services
- quick startups that save time and money
- instant name brand recognition and identities
- knowledge of the market and how to immediately gain customers
- partnership with successful franchisors and fellow franchisees
- greatly enhanced chances of success

Those are just a few of the benefits new franchisees acquire in return for their initial franchise fees. Compare those advantages to the months of startup problems, years to build market identity, location mistakes, and learning about the business through trial and error, etc., which are the norm for new independent ventures.

Royalties

Franchisees typically pay ongoing fees or royalties. The formulas vary from company to company, but typically they range from four to six percent of sales.

Ongoing royalties should represent good value to franchisees. In return for the fees, the major returns on investment owners receive include:

- administrative and logistical support services from the franchisors
- business plans that are constantly being refined and enhanced
- constant product research and development
- intense training that keeps franchisees “ahead of the curve”
- the benefits of collective purchasing
- brand and name protection
- participation on franchise teams where fellow franchisees are peers, not competitors

Franchise fees and royalties frequently are used for marketing and advertising programs to attract new customers. Those programs benefit individual franchisees who likely could not afford such extensive efforts as individual business owners.

Simple tasks such as designing and printing stationery, acquiring appropriate insurance coverage, implementing personnel policies, and setting up inventory control systems, etc., are important to business success. Franchisee fees and royalties insure that those mundane, yet vital, tasks are provided for franchisees. Such tasks too often are put on the back burner or slip through the cracks for independent businesses. They often are done poorly, or not at all, and the businesses suffer.

Pre-Qualified Owners

One of the most significant benefits—albeit hidden and indirect—provided by good franchise companies is the fact that they only award franchises to candidates who they are confident will succeed. Those pre-screened and qualified candidates are entrepreneurs who are most likely to succeed in business ownership.

Entrepreneurs' capital resources represent perhaps the most important ingredient to their business success. It simply takes adequate capital to start, maintain, and take new enterprises to profitability. New entrepreneurs too frequently start their ventures with inadequate capital resources.

Franchisors know how much money typically is required to start their units and to take them to profitability. They therefore discourage under-capitalized candidates and do not award valued territories to them. That caution saves under-capitalized entrepreneurs from getting into businesses where the odds would be against them from the beginning.

Compare that qualification process to the independent startup world. Anyone can start a new independent business by coming up with a name, purchasing a telephone listing and business cards, and announcing "*We're in business.*" Quite frequently, however, they are under-capitalized from day one and end up purchasing "**Going Out of Business**" signs a few months later.

Obtaining Financing

Not only do new entrepreneurs need existing capital to start businesses, most have to obtain additional financing. It generally is much easier to obtain financing for franchises than for independent startups.

Lenders and agencies like the Small Business Administration are very aware of the comparative success and failure rates of independent startups and new franchises. They know that franchises are much more likely to succeed.

Franchise borrowers bring detailed business plans and the collective experiences of their franchise systems to the financing table. Lenders further recognize that franchisees will be trained to the industry's highest standards and will not be learning the new business by trial and error.

Prospective franchisees also have full access to the franchise's current and past owners. That means they can conduct extensive research into the performance of those units and include the data in projections provided to lenders. Franchise loan applications will be based much more on actual facts and experience than the speculative numbers often submitted for most independent startup ventures.

Find the Model “Right” for You

As the above points illustrate, franchises can be superior business models for individuals wanting to start new ventures. However, franchisors tell applicants everyday that franchising is not necessarily for everyone. Some people will be happy only waging the battle of starting a new independent enterprise on their own. Those entrepreneurs need to be prepared for a long, hard struggle, and to take advantage of all appropriate professional assistance.

Other entrepreneurs will find that the franchise model's inherent advantages and systematic approach to business provides greater chances of success and profitability. Because business growth is more predictable and steady, owners often find that it ultimately gives them more time to enjoy life and makes personal goals more attainable.