

# **A Decade of Growth: Lessons Learned from the Transformation in Franchising**

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## *Executive Summary*

*Our research indicates a significant transformation is underway that not only impacts franchisers and franchisees, but also has implications for executives and managers in non-franchised businesses. Those leaders who are able to grasp the changes underway and catalyze their companies to take advantage of them will not only increase performance in the short-term, but will create value for all stakeholders in the long-term.*

Some business revolutions have a definite starting point; others begin with a series of small changes that oftentimes go unnoticed but accumulate to create a new paradigm. Over the past decade franchise companies have experienced an accumulation of incremental changes that now impact them in significant ways.

What is the transformation underway in franchising? What best practices of franchisers and franchisees enable them to win? And what sources of competitive advantage can you use to position your company to out-perform others? This is the first of a three-part series exploring the changing nature of franchising and tactics companies are using to out-perform others.

Our methodology for understanding the transformation in franchising is straightforward. We refer to research I conducted for my book, *Franchising Dreams*, to develop a factual and empirical baseline of franchising a decade ago. As part of that research I worked in the front-line operations and also with major franchisers. Based upon that earlier work we identified five changes that are beginning to shape the future of franchising, summarized in the chart below.

### **Change 1: From Win-Lose to Win-Win**

Academics say that the trademark is the “cornerstone” of franchising, but for most franchisers and franchisees the trademark is secondary to the relationship both parties have to each other. Ten years ago a win-lose framework predominated franchising. Franchisers controlled franchisees through a one-sided contract or through heavy-handed management techniques. Franchisees countered by ignoring the franchiser, by forming councils to circumvent the franchiser, or by litigation.

Today the best practice is to develop a win-win framework. States Russ Reynolds, CEO of Batteries Plus, “Franchising is a lot about conflict, a lot about constructive tension. We’ve learned that we have to agree to disagree sometimes, but the important thing is to keep a clear vision and try to advance that.”

One manifestation of a win-win framework is that disputes are more often resolved through mediation rather than litigation. “Litigation breaks down the franchise relationship,” states Nancy Weingartner, editor of Franchise Times, “but with mediation it's more of a problem solving opportunity that allows you to end up with a stronger relationship.”

## Transformation in Franchising

1993		2003
Win-lose relationship between franchisers and franchisees	→	Win-win relationship between franchisers and franchisees
Franchiser motivation: Control the system	→	Franchiser motivation: Create profit and growth
Franchise business model applied to national market with traditional franchisees	→	Franchise business model applied to global markets with non-traditional franchisees
Franchisees own a single-unit, operate under single brand	→	Franchisees own multiple units, operate under multiple brands
Franchisee motivation to buy a franchise: steady income	→	Franchisee motivation to buy a franchise: Investment opportunity

### Change 2: Franchiser Focus in Creating Profit and Growth

A decade ago one of the overriding goals of franchise companies was enforcement of system standards. As a CEO of a Fortune 500 company noted, “A manager will do what you want but won’t work hard; a franchisee will work hard but won’t do what you want.” Since franchisees are typically dispersed across large regions field support staff were employed to ensure that franchisees followed the methods and practices of the franchiser and kept the trademark value high.

Today the most pressing need for most franchise companies is to provide growth opportunities to franchisees. Ken Walker, President and CEO of Meineke stated, “We’ve learned that to be successful at franchising we have to keep the company’s ego in check because it’s all about franchisees and making them successful, not about the franchiser.” Chad Hallock, president of Budget Blinds concurs. “The difficult part about being a

franchiser is making sure that one plus one equals three. If you're not doing that then you're not adding value and you shouldn't be in the franchise business."

### **Change 3: Franchiser Business Model Becomes More Complex**

Compared to a decade ago, franchiser business models have become more complex due to technology, globalization, and emerging domestic markets. Like most companies franchisers have had to assess the magnitude and breadth of technology on all employees, and measure both the true cost and benefits. Beyond this, however, technology has impacted a franchiser's ability to generate leads. As Greg Tanner of Quiznos notes, "We get about 16,000 leads every quarter and can only sell a fraction of that. Even though we're selling a franchise every 4 hours and opening a store every 16 hours, our biggest challenge is qualifying all the people that contact us."

Ten years ago franchisees were largely similar across a range of characteristics and franchisers could manage franchisees with a one-size-fits-all approach and be effective. But as franchisers expand globally they must deal with people from different cultures, backgrounds, and with different values. Today franchisees are more diverse and a one-size-fits-all approach spells disaster.

Compared to ten years ago, franchisers are exploiting non-traditional markets more effectively. According to C. Everett Wallace, director of the National Minority Franchising Initiative, some franchisers are focusing on emerging domestic markets rather than global markets. "Many companies are realizing that there is a lot of growth in markets that have been traditionally underserved and neglected—and they're right here in our backyard. Urban markets have a high density population, speak our language, use our currency, and share our values."

### **Change 4: Franchisee Business Model Becomes Complex**

The franchisee business model has also become more complex as franchisees own multiple units and operate under multiple trademarks. Ten years ago most franchisees operated units within a single brand, and their business model was fairly simple: Learn the business and follow the system. Today some franchisees operate two brands in the same location, such as a McDonald's in a Mobil gas station, or a Dunkin' Donuts with a Baskin Robbins 31 Flavors.

Others, such as Charles Smithgall of Aaron's, own multiple units. Smithgall currently has 43 stores with plans to own 100 by 2008. And Carrols Corporation, the largest Burger King franchisee, currently owns 355 restaurants, has over 16,000 employees and revenues over \$650 million.

Finally, some franchisees own multiple units in multiple systems. Joe Cody, for example, is a franchisee with the Old Chicago chain, but also operates restaurants in five other systems as well as several restaurants of his own. "Some franchisers don't like the fact that we're so diversified," he states. "They'd like allegiance to just their system. But there are a lot of benefits in being involved with different systems. You not only spread your risk, but you learn a lot more."

## Change 5: Shift in Franchisee Motivations

A final transformation in franchising involves the motivation for people to buy a franchise unit. Ten years ago people bought franchises for primarily two reasons: either because they were pursuing the “American Dream” of owning their own business, or because they wanted the security of a franchise. Today the motivation is not so much the American dream or security, but the expected financial returns.

Consequently today’s franchisees are more sophisticated, more knowledgeable about business, more likely to have significant business experience, and more often have an advanced degree such as an MBA, compared to franchisees ten years ago. Companies have responded by providing full and accurate information on expected returns. In the past potential franchisees had to discover the financial returns but today the best practice of leading companies such as Aarons, Jimmy Johns Gourmet Sandwich Shop, or McDonald’s, is to provide prospective franchisees with financial data on overall revenues, breakeven, and operating expenses.

### The Challenge

In the early 1990’s franchise companies could win with a relatively formulaic approach to the business: Write an iron-clad agreement, sell as many units as possible to saturate the market, and approach franchisees in a one-size-fits-all manner. Today that formula doesn’t work as well. Franchiser and franchisee business models are more complex, franchisees are more diverse and sophisticated, and the most successful companies focus on creating win-win relationships and profitable franchisees.

We believe that those companies that are able to think strategically about how to compete given the transformational changes, those that are able to manage both their distribution and supply channels, and those that are able to add value to franchisees will reap the rewards of long-term growth. The second part of this article will bring to light those companies that are best-in-class in managing the transformation.

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