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# Franchise Management

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you need

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makes money

**Michael H. Seid**  
**Joyce Mazero**





# Franchise Management

by Michael H. Seid, CFE,  
and Joyce Mazero, JD

for  
**dummies**<sup>®</sup>  
A Wiley Brand

## Franchise Management For Dummies®

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# Foreword

by Robert Cresanti, CFE, President and Chief Executive Officer,

## International Franchise Association

In your hands is a powerful book that holds essential keys to running a successful franchise business. It is crucial that prospective business owners and entrepreneurs understand how to properly navigate the franchise business model, and *Franchise Management For Dummies* by Michael Seid, CFE, and Joyce Mazero offers a step-by-step approach to establishing, operating, and expanding your franchise. I've had the privilege of working with Michael directly in his role as an active member of the International Franchise Association Board of Directors. When I first joined IFA, I was repeatedly told to first speak with Michael and read his writings about franchising, including the older title, *Franchising For Dummies*, published a decade ago. His insights served as foundational elements to understanding the business model. To this day, when I need advanced/master crafted counsel on franchise issues, Michael and Joyce are at the top of my "must call" list.

I cannot think of anyone more qualified than Michael and Joyce to write this much-needed book. It contains in-depth information on the history and framework of franchising, including the three types of franchising: traditional, business format, and social. There's instruction on how to research and select the franchise concept that's right for you and what to know when franchising to multiple units. It also includes sections on raising capital, choosing and managing locations, conducting legal due diligence, setting up supply chains, hiring, training, acquiring existing franchises, and mapping out exit strategies. There are even chapters for lovers of top ten lists, covering the ten keys to success and ten questions to ask before investing in a franchise.

Applicable to all levels of franchising from a single-unit franchisee to a large franchisor, *Franchise Management For Dummies* spans the entire life cycle of a franchise business from start to finish.

Franchising is about people and relationships, both inside and outside your organization, which is why the sections on working with fellow franchisors and franchisees is so important. Attracting and keeping customers is another one of my favorites. The lessons in this book go beyond franchising to address how to build

relationships and design processes that are beneficial to everyone in the organization.

This book is essential reading for anyone who is seriously examining the road to small business ownership. Michael and Joyce's deep knowledge of the franchising industry, easy-to-remember terminology, and thought-provoking format makes this the ultimate blueprint for franchising.

According to a January 2017 report from IFA's Franchise Education and Research Foundation and IHS Markit Economics, employment growth in the franchise sector again outpaced the U.S. economy as a whole in 2016, building on a multi-year trend that is expected to continue in 2017. The franchise business model accounts for nearly 8 million jobs at more than 744,000 establishments in the U.S. alone. It offers a path to business ownership at a reduced risk by using existing brands and operational practices.

I'm grateful to Michael and the IFA Board of Directors for their dedication to protecting, enhancing, and promoting franchising. *Franchise Management For Dummies* is an extension of these efforts, as it clearly defines franchising, and in doing so lays out the compelling case why the business model is so important to the U.S. economy and throughout the world.

# Introduction

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**W**elcome to *Franchise Management For Dummies!* In our opinion, it's not an overstatement to suggest that because of franchising, our lives have improved immensely. We now have access, on seemingly every street in the world, to an ever-growing expanse of high-quality branded products and services delivered consistently from location to location, regardless of where we shop. Franchising is also responsible for creating significant wealth in the United States and globally through local ownership of businesses supported by franchise systems. Each of those locally owned businesses creates jobs that drive our economic health.

Franchising has also become the most important and largest vehicle for training entrepreneurial skills, while providing the “first rung” on the career ladder for many young people. Just consider the sheer number of people whose first jobs were working at a branded franchised location. In addition, in the past few years the methods and standards found in commercial franchising are being applied to many of the health and economic problems in the developing world. *Social franchising* is a transformational way of delivering products and services to individuals and their families at the base of the economic pyramid (see Chapter 17 for more). Social franchising holds the promise of not just saving countless lives, but of transforming economies that have held people back from achieving a better life for themselves and their communities — not bad for a method intended to create wealth and bring quality products and services to consumers in the industrialized world!

## About This Book

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Franchising is complex—no one book can provide a complete understanding of its dynamics. That's why we focus on what we believe are the most important elements. In some areas, because they are so complex, we can only go an inch deep and a mile wide. Transforming a complex business approach with so many variations into a friendly consumer book has its challenges and limitations. We highlight those areas we think will provide you with the most benefit. Where we see potential gaps, we remind you to seek professional and experienced help in franchising. In fact, we can do even more than that: Your friendly authors, Michael Seid ([mseid@msaworldwide.com](mailto:mseid@msaworldwide.com)) and Joyce Mazero ([jmazero@gardere.com](mailto:jmazero@gardere.com)), are available when you need us.



TIP

Franchising is a dynamic method of expansion. It will continue to change for many reasons — new methods are constantly being adopted, and technology is changing all the time — but don't worry, even an old dog can learn new tricks. We have created a companion Dummies.com website (more on this later) to keep the information fresh. We will also likely ask other professionals we respect in the world of franchising to contribute to the website, so we strongly recommend — even if you've studied every page of this book — that you check out the companion website.

Most of this book is about franchising as practiced in the United States. After all, modern commercial franchising is a U.S. product, and commercial franchising made its debut in the U.S. under the leadership of one of our founding fathers well before we became an independent nation. (Curious who the first franchisor in North America actually was? Check out Chapter 1.) That said, franchising's importance has grown globally, creating jobs and wealth along the way, because it has the capacity to sustainably and consistently replicate products and services. Its importance is now part of the solution for addressing societal and community needs in emerging markets in Asia, Africa, South America, and elsewhere. Franchising is even being used to effectively deal with the delivery of social services in the industrialized world. Whether you are located in the U.S. or anywhere else in the world, and whether you are in commerce or trying to tackle a societal problem, know that the basics of what makes franchising successful are universal.

## Foolish Assumptions

Michael recalls sending out a copy of the original edition of *Franchising For Dummies* — which he and Dave Thomas, founder of Wendy's, co-authored — to the chairman of one of his firm's clients (a brand you know very well). We laughed at the note he sent back which said "Great book, learned a lot, could you send a brown paper cover for it so I can put it on my bookshelf?" All kidding aside, rest assured that you are no dummy for reading this book — in fact, quite the opposite. The *For Dummies* series carefully unwinds complex subjects and transform them into friendly, easy-to-read books.

Our goal for this book is be an essential resource for both novices and experts in franchising. Prospective franchisees can find out what to look for in a great franchisor; existing franchisees can take a peek at what great franchisors are providing their franchisees; emerging and experienced franchisors can gain an understanding about the proper methods of structuring, managing, and expanding their franchise systems; and social impact investors, donors, and NGOs can learn how franchising techniques can transform how they look at providing products and services at the base of the pyramid.

Of course, everyone has *some* understanding of franchising — it's part of our daily lives after all, and most people shop at a franchisee-owned location nearly every day. But many don't stop to realize that they are shopping at a business owned and operated by their neighbor. Franchisors have done such a good job in designing, developing, and managing franchise systems to deliver on a consistent brand promise that many people, including some legislators, believe that franchisees and franchisors do more than share a brand.

Although the sign above the front door may bear the name of a national chain, the name on the lease, on the paychecks, and on the purchase orders is the name of someone local who is risking their capital for the future success of the business. Franchising may be about chain businesses, but *Franchise Management For Dummies* will show you that sharing a common brand and sharing ownership are not the same thing.

## Icons Used in This Book

Throughout this book, icons in the margins highlight different types of information that call out for your attention. Here are the icons you'll see along with a brief description of each.



REMEMBER

This points out stuff you should tuck in your brain for future reference.



TECHNICAL  
STUFF

If we start digging into a topic beyond the essentials of what you need to know, we warn you with this icon. If you're looking for an in-depth discussion, dig in; otherwise, you can safely skip ahead.



TIP

Tips provide hard-earned insider insights. When you're looking for a better, faster way to do something, pay special attention here.



WARNING

This flags things to watch out for and avoid — proceed with caution.



PLAY THIS

This icon points out more goodies to be found on the companion website.

# Beyond the Book

As we've been bragging about, an abundance of information and guidance on franchise structure and management is provided in this book, but not even we could cover every element in the detail required and still fit it all between these covers. That's why we offer a whole lot more help and information online — just go to [www.dummies.com/go/franchisemanagementfd](http://www.dummies.com/go/franchisemanagementfd). This site is chock full of additional information, including more depth on legal issues, advice on structuring your franchise program, tools to help you select and evaluate franchise opportunities, and much more. Check out the Franchise Management For Dummies Cheat Sheet. Simply go to [www.dummies.com](http://www.dummies.com) and type “Franchise Management Cheat Sheet” in the Search box.

## Where to Go from Here

You've embarked on a journey. Congratulations. Neither Michael nor Joyce can be with you in person as you make this journey (unless you give us a call or shoot us an email). We have tried to be your trusted guides throughout this book, and you can consider *Franchise Management For Dummies* to be your roadmap — in a simple, straightforward, and (we hope) entertaining way.

To make the journey, of course, you have to read this book. For the best experience, we suggest simply starting with Chapter 1 and going from there. Certainly if you're new to franchising, starting at the beginning and reading it all the way through would be a good approach. Feel free to flag those sections that you think are the most important to you or that you may not have understood fully. Then go back and read them again — with a broader knowledge of franchising, they may start to make better sense to you.

You can also read each chapter (and even each section) independently, which is useful if you have other things to do at the moment. In each chapter, we note other areas of the book that explore in greater detail some of the information you see.

If you're experienced in franchising, you may want to skip some of the more introductory chapters and focus on the subjects that interest you most or where you need additional guidance. You can use the table of contents or the index to find what you're looking for and flip directly to those sections. And of course, make certain you take advantage of the material on the website.

We hope this book gives you a valuable jumping-off point as you make your franchise decisions. Simply turn the page and begin!

# 1 Wrapping Your Brain Around Franchising

## **IN THIS PART . . .**

Explore a bit of the surprising history of franchising and get to know the roles of franchisor and franchisee.

Check out the different kinds of franchised businesses and franchising arrangements.

Understanding the similarities and differences between entrepreneurship and franchising to see if franchising is right for you

Dive into a franchisor's mandatory legal obligations to prospective franchisees, the franchise disclosure document (FDD), and working with franchise professionals.



## IN THIS CHAPTER

- » Exploring the history of franchising
- » Defining a franchise and the roles of franchisor and franchisee
- » Getting to know franchise wannabes, and why should you avoid them
- » Understanding the rights you will be granted under a franchise agreement

# Chapter 1

# The Power of the Brand

Three constants have fueled the growth of franchising over its long history: the desire to expand, the limitations on human and financial capital, and the need to overcome distance. Although you may think of franchising mostly in the context of your neighborhood fast food outlets, franchising has transformed how we purchase products and services today. More than 120 distinct industries use franchising today, and because of that it is nearly impossible to drive down any major street in the world and not pass by some business that is part of a franchise network. This chapter begins your exploration of franchising, not by looking at any particular franchise but by giving you some of the basics so you can better understand what franchising is all about.

## Tracing the History of Franchising

Franchising seems ageless and omnipresent. It is used commercially today in over 120 industries to deliver to us all types of products and services in a way that allows us to trust in the consistent quality of the franchisor's brand. It is also now being used by social enterprises such as nongovernmental organizations (NGOs) to bring fresh water, healthcare, education, electricity, and countless other products and services internationally to people living in underdeveloped parts of the world.

Franchising is a way for companies to expand and bring their products and services to consumers without the company owning and operating their locations directly. It is a way to create wealth through the establishment of independent local businesses. In addition to creating jobs at those independently owned locations, franchising is the single largest engine of entrepreneurial training in the world and has consistently been one of the driving forces in creating new entry-level jobs in every market in which franchising exists. It is one of the most productive methods ever adopted for the creation of wealth, capital formation, and a solid middle class.

Franchising is not new and it wasn't invented by Ray Kroc or McDonald's. It stems from systems used long ago by governments and by the church. Consider the legends of Robin Hood and Camelot. If you examine the relationships between the kings and the nobles, you can begin to understand the historic impact of franchising. It would have been impossible for the heads of government then to effectively control expansive territories, raise armies, regulate commerce, collect taxes, and provide government services without a structure that provided territory to nobles — who in exchange acted on behalf of the government and shared the local taxes and fees collected. That is, essentially, franchising. Even today, the continuing fee paid by franchisees to franchisors is called a *royalty*. A similar relationship was used by the churches and effectively still is. Franchising allowed for global exploration and commerce, and companies like the Dutch East India Company and the London Company used it to establish trading areas and explore the globe, including North America.

Franchising was first used commercially by European brewers for the distribution of their products to pubs. The first recorded commercial franchise in North America was created by Benjamin Franklin in 1731 in the British colonies, before the United States became a nation. Benjamin Franklin was the Postmaster for the Colonies under the British, and 45 years before the United States became a nation, he and Thomas Whitmarsh entered into the first franchise, or what they called a “Co-partnership,” for the carrying on of the “Business of Printing in Charlestown in South Carolina.” The printing shop published *The South Carolina Gazette* and was the local printer of many of Franklin's writings, including his *Poor Richard's Almanack*. Franklin went on to establish other franchises in the colonies and elsewhere in the years before the Revolution. His third franchisee was Elizabeth Timothé — a woman. At a time when commerce was substantially male dominated, Elizabeth Timothé is recognized as the first female publisher in North America.

Franchising also played a major role as the United States began its territorial and technological growth. Governments granted monopolies to franchisors for the development of railroads, ferries, electricity, roads, and trading posts needed for municipal infrastructure.



PLAY THIS

For more on the history of franchising, check out the companion website (search “Franchise Management” at [www.dummies.com](http://www.dummies.com)).

# What Is a Franchise, Anyway?

*Franchising* is, in a word, a *license*. It is a system for independently owned businesses to share a common brand, distribute products and services, and expand. It's a contractual relationship between a brand owner (the franchisor) and an independent local business owner (the franchisee).

For example, Bright Star Care doesn't "franchise" medical and non-medical home care assistance, FASTSIGNS does not franchise printing, Wetzel's Pretzels does not franchise pretzel shops and Dat Dog does not franchise hotdogs, sausages, and beer. What each "franchises" is a system that delivers quality branded products and services to consumers. And they do so through a network of independently owned and operated businesses that deliver a consistent customer experience.

"Dat Dog is an experience," says Bill DiPaola, president and COO of Dat Dog, based in New Orleans. "It is more than simply the great food and expansive assortment of craft beers that make us successful and that will make our franchisees successful. It is our commitment to community, married with the fun and 'zany' culture of Dat Dog, that brings our customers back and that is the approach we expect our franchisees to take in each of their restaurants."

A franchise occurs when a *franchisor* licenses its trade name and intellectual property — the *brand* and its operating methods (its system of doing business) — to a person or group who agrees to operate their business to the franchise system's brand standards. The franchisor defines the brand promise it wants delivered to consumers, provides the franchisee with initial and continuing support, and then ensures compliance by the franchisee on how it delivers on that brand promise. The magic of franchising is that consistent brand standards can be achieved at each location without the franchisor being involved in the day-to-day management of the franchisee's business.

In exchange, the franchisee pays an initial *franchise fee* to join the system and a continuing fee known as a *royalty* to remain a part of the franchise system.

## The effects of franchising on modern business

We have grown accustomed to the consistency that comes from shopping at branded locations. From the comfort of knowing exactly what you will find when you check into a Courtyard by Marriott, to the quality of the chicken at a Popeye's Louisiana Kitchen or a haircut at Sport Clips, people know what they will get when they purchase under a franchisor's brand. The number of companies and

industries bringing goods and services to consumers through franchising is growing, limited only by the imagination of the people who understand its potential application.

The size and impact that franchising has had on the economy in the United States is often unrecognized. According to the Franchise Education and Research Foundation, business-format franchising in 2017 is projected to generate close to 8 million jobs in the U.S., accounting for over \$700 billion in economic output and over \$425 billion in gross domestic product from more than 744,000 establishments. In a recent survey, more than 76 percent of American consumers favorably viewed shopping at a locally owned franchise business in their neighborhood. That's the power of franchising today.

## The success of franchising for business owners

Franchising creates opportunities for business ownership to create personal wealth and generates local jobs. It also consistently delivers products and services on a global basis to the brand standards established by the franchisor.

As you explore becoming a franchisee or a franchisor, be wary of statistics that talk about the “success rate” in franchising. As late as 2000, the International Franchise Association published statistics that claimed that franchisees had a success rate of 95 percent — versus a *failure* rate of 85 percent for nonfranchised startups in their first five years in business. Those statistics turned out to be inaccurate and misleading.



WARNING

The IFA has frequently reminded franchisors to not use those out-of-date and misleading statistics, but unfortunately, some franchisors, franchise brokers, and franchise-packaging firms (one-stop shops that offer “cookie-cutter” franchise advice) continue to use them to attract potential franchisees. What should be important is how well a franchise system is doing, and it is irrelevant in choosing any franchise opportunity whether or not franchising in general is doing well. You should be very wary of working with anyone who still uses invalid claims of franchise industry success statistics. In fact, we recommend strongly that you don't work with them at all.

Franchising can be a very effective method of getting into business, but that depends on how carefully the franchise system is structured and supported. Even in highly successful franchise systems, locations *can* fail for a host of reasons. It is up to prospective franchisees to conduct a proper examination of every franchise opportunity that interests them.

# What's the Big Deal with Brands?

The *brand* is a franchise system's most valuable asset, because consumers decide what and whether to buy based on what they know, or think they know, about the brand. Unless a consumer has a personal relationship with the local owner of a franchise, they probably don't give any thought to who owns the local business. In their minds, they are shopping at a branch of a chain. This fact is evident in the signs most franchisors require franchisees to post in their locations notifying the public that the location is owned and operated by a local business owner. In the consumer's mind, a company's brand equals its reputation.

"Many brands spend too much time talking about what and how they do things," says Dawn Kane, CEO of Hot Dish Advertising. "Where brands win is when they connect emotionally to the customer. You can't build a solid reputation without that emotional connection. It is the emotional connection that drives consumers into a franchisee's location, and each location's consistency in meeting that brand promise keeps them coming back."

Franchisors focus much of their support effort, time, energy, and money ensuring consistency at each of their locations. This promise of consistency is a major advantage for new franchisees because it is meant to assure them a ready flow of customers. A good brand can communicate a positive message to the customer. Equally so, a bad brand experience can paint a negative message for the entire brand. With a great brand, consumers can visualize and almost feel the experience they will receive even before they enter the local business.

A positive brand recognition is what every franchisee hopes for. With a well-known successful brand, new franchisees don't have to build brand awareness for their business because the franchisor and the other franchisees have already taken care of that. Having a reputation for a positive brand experience is one of the major advantages found in well-established franchise systems.

But brands are not born fully grown. Smaller franchise systems or those with limited brand recognition in markets can't deliver consumer acceptance until the local franchisee creates a reputation for a positive brand experience in their market. This is an issue for new franchisees because they may be required to build brand recognition by spending more on advertising and promotion than where the franchise system's brand is well known. When prospective franchisees review the franchisor's offering, the amount of advertising specified by a franchisor is only the minimum amount they expect will be required — but most certainly is not the maximum amount a new franchisee may need to invest.

# Franchise Siblings: Three Types of Franchising

There are three basic types of franchising:

- » Traditional or product-distribution franchising
- » Business-format franchising
- » Social franchising

## Traditional franchising

The industries in which you most often find traditional franchising include soft drinks, automobiles and trucks, mobile homes, automobile accessories, and gasoline. The franchisee is typically selling products manufactured by the franchisor. Some examples include Coca-Cola, Ford Motor Company, and John Deere.

Although traditional franchises look a lot like *supplier-dealer relationships*, the difference is in the degree of the relationship. In a traditional franchise, the franchisee may handle the franchisor's products on an exclusive or semi-exclusive basis, while the supplier-dealer may handle several products, even competing ones. For example, Tempur-Pedic mattresses may be offered by a national dealer network that also offers other bedding brands in their retail stores.

The traditional franchisee is closely associated with the franchisor's brand and generally receives more services from its franchisor than a dealer would from its supplier. Frequently the franchisee provides some pre-sale preparation before a product is sold (such as you find with Coca-Cola, where the franchisee manufactures and bottles the soda) or some additional post-sale servicing (such as you find at a Ford dealer with your periodic maintenance programs).

In a traditional product-distribution franchise, the franchisor licenses its trademark and logo to its franchisees, but it typically does not provide franchisees with an entire system for running their businesses. Measured in total sales, traditional franchising is larger than business-format franchising, covered in the next section.

## Business-format franchising

The *business-format* franchisee gets a complete system for delivering a franchisor's product or service. The major difference between a traditional franchise and