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Seven Milestones

Concept may be ready to franchise when it meets major goals

By Dennis L. Monroe

When considering how to grow a concept, it's hard to overlook the advantages of franchising. But before making the decision, thoroughly explore if franchising is in fact the right approach to grow the concept. Too often it is used as a fallback position when other techniques for growth may be more appropriate. The same advice is valid for companies already franchising, but whose growth has stalled. Make sure you too have covered these seven milestones.

Every concept owner should look to franchising if the concept has a clear, understandable and definable business format; is not overly capital-intensive (in most cases); and does not require a unique skill set. Many concepts (particularly big-box concepts that have a lot of individuality and uniqueness to them) would more readily benefit from joint ventures, corporate store development with outside equity and possibly straight licensing rather than franchising as a way to grow.

Knowing when a concept is ready to franchise is more of an art than a science. It is sometimes easier to determine when a concept is not ready to franchise than when it is.

The first question I am always asked is, "To franchise, how many units should a concept have?" Increasingly, I see people begin the franchising process after the first unit is developed because the consumer has become enamored of that unit. This is a major mistake. There is no magic number dictating when a concept should be franchised. What really matters is the experience of having developed enough units where the necessary mistakes were made, and the concept has now been sufficiently refined to be replicated. I continue to be concerned with anyone who franchises unless they have at least 10 units — and I would prefer even more.

There are seven different milestones that need to be reached in order to effectively franchise:

Unit economics. This is the most important milestone in determining whether a concept is ready to franchise. Are the units making enough profit on the unit level after accounting for theoretical royalty, advertising charges and reasonable general administrative expenses? I like to see unit level profit, after all of the above-listed charges, at no less than 10 percent. In most cases, great franchise businesses generate closer to 20 percent at the unit level.

In terms of unit economics, if possible, the ratio of sales to investment should be higher than two to one. The most desirable ratio is three to one, and the theoretical return on investment (assuming a reasonable amount of leverage) should be in the 20 percent-plus range.

Demographics. Is there a clear understanding of who the consumer is for the concept? How broad-based is that demographic? Can other locations be readily found that have a similar demographic where the units will work? How can the concept broaden its demographic appeal?

Geographic diversity. Has this concept been tested and proved in different geographic locations? What geographic locations seem to work? Is this a southern, western or northern concept? Is it a small town, metro or urban concept? These questions need to be clearly answered before a franchising program begins.

Infrastructure. Has the concept owner developed an infrastructure, processes and procedures (known as standard operating procedures) that clearly provide for a successful business and, if followed by a franchisee, will result in a successful unit? This infrastructure also needs to include the appropriate human element, which is good development, operations, research people who continue to keep the concept fresh, and legal compliance resources. Such a framework does not need to be entirely in place at the beginning of the franchise process, but having available dollars in order to build this infrastructure within a reasonable amount of time is vital.

Franchisee community. What is the potential franchisee community? Is it large multi-unit operators or mom-and-pops? Is it job replacement? Is it non-traditional, such as airports and colleges? Once you identify the franchisee community, determine if there is acceptance within this community for the concept. Has it been possible to beta test this potential franchisee community to understand if there is a market for the concept?

Funding. Is there adequate funding? Franchising is a very expensive proposition. In addition to the initial legal and filing fees, there is the cost of capitalizing the company so that a potential franchisee and the regulatory authorities know it has staying power. This means the company has the resources (particularly equity) to build the infrastructure discussed above, to be able to adequately service the franchisee community and to move the concept ahead.

Temperament. Does the management of the current company have the ability to let others run this concept? Can the management accept second guessing, endure litigation and create a partnership with the franchisee community?

Franchising is a wonderful method of expansion. But sometimes it is taken too lightly, entered into too early, and undertaken without the capital necessary to be effective. Use the above milestones to evaluate and grow a concept. FT

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