Should You Franchise Your Business?

In the decades since late industry legend Ray Kroc began selling McDonald's franchises in the 1950s, franchising has become a proven way to rapidly create a national chain. Here are seven questions to ask yourself if you're looking to expand your business. BY CAROL TICE

Ben Davis always hated getting his hair cut. The former insurance-startup executive wanted to start a business he could grow into a national brand, so he decided to create one that offered a better haircut experience.

His brainchild is The Gents Place, an upscale men's grooming and lifestyle club that opened its first location in Frisco, Texas, in 2008. The chain's members pay up to $8,000 a year for straight-razor shaves, shoeshines, manicures and other pampering in a classy, wood-paneled setting. The Gents Place thrived by becoming a haven for stressed-out CEOs and startup entrepreneurs and opened three additional clubs in Dallas and Kansas City.

"It's not just upscale men's grooming," Davis says. "We're in the business of empowering confident gentlemen to change the world."

With the clubs pulling in more than $1 million in annual sales apiece by early 2016, The Gents Place was ready to grow through the time-tested method of selling franchises.

By summer's end, hope was high at The Gents Place, with Davis reporting strong interest from potential franchisees and several deals in

ILLUSTRATION BY MARK SMITH / SALZMANART

progress. He expects to see roughly half a dozen Gents Place franchise deals signed before year-end.

Every year, hundreds of eager entrepreneurs strive to franchise their business. Their interest is fueled in part by the megasuccess of chains such as Five Guys Burgers and Fries, which began franchising in 2002 and now has more than 1,000 restaurants.

But simply filing the legally required paperwork to become a franchisor is no guarantee of success. Of 318 franchise brands that debuted in 2012, more than 100 are now "inactive," according to industry research and advisory firm FRANdata. That means the brands haven't registered to sell franchises for at least three years.

Why do some businesses succeed in selling franchises, while others find no takers? If you're thinking about franchising your business, consider the following:

1. IS YOUR MODEL PROVEN—AND PROFITABLE?

Franchise experts often hear from entrepreneurs who have an idea for a franchise chain. But it's tough to sell franchises for a business that exists only in your head, says Michael Seid, managing director of the franchise-consulting firm MSA Worldwide in West Hartford, Connecticut. Prospective franchisees are looking for a concept with a track record of proven success, ideally at multiple units.

"No one with any sense is going to develop a franchise without a prototype," Seid says. "Your franchisee is not your guinea pig. If Ray Kroc [the founder of McDonald's] came back to earth today, showed up at my door, and said, 'I want to franchise a new burger chain,' I'd say, 'Why don't you go open one?' "

Successful franchisors usually operate for years and slowly improve their margins before they sell franchises. For instance, 5 Guys Burgers and Fries opened its first restaurant in 1986, but didn't begin selling franchises until 2002.

It's important that franchise models be highly profitable. That's because franchise owners pay a monthly royalty to the franchisor—typically, 5 to 6 percent of sales. There's also an initial franchise fee that can range as high as $35,000 or more. Margins need to be high enough that the franchise owner still makes a profit after the franchisor takes a cut.

One big reason longstanding operators often see better success selling early franchises is because they're able to share average annual sales figures in the federal Franchise Disclosure Document that all franchisors must file in order to sell franchises. Brands just starting out that don't yet have sales figures are seen as riskier propositions, says independent franchise adviser Joel Libava, who's the author of *Become a Franchise Owner! The Start-Up Guide to Lowering Risk, Making Money, and Owning What You Do.*

"A very small percentage of the people I talk with are open to being a first or second franchisee," he says. "They have to be looking to get in on the ground floor of something that could turn out to be big."

A CHOCOLATIER TASTES SWEET SUCCESS

What does it take to turn a family chocolate business into one of *Entrepreneur* magazine's top new franchises of 2016? In the case of Chocolate Works of Valley Stream, New York, it took almost 40 years, a name change, new leadership, a wife's inspiration, a 1,200-page operations manual, a pro franchise team and more than $1.5 million.

The journey began in 1999, when son Joe Whaley took the helm from father John Whaley at what was then gourmet chocolates purveyor 5th Avenue Chocolatiere. His wife Colleen Whaley's idea to boost business? Let people make their own chocolates at the factory—and have parties.

Response was enthusiastic: A typical party rang up nearly $700. Whaley began hearing from entrepreneurs interested in opening a standalone chocolate-party store.

Whaley developed a retail store prototype so the concept could fit in a typical mall space. For the new format—renamed Chocolate Works—he had to invest in creating downsized candy-making equipment that would fit in a 1,500-square-foot store. Now, what Build-a-Bear Workshop did for buying a stuffed animal, Chocolate Works does for buying a box of chocolates. "It's like Willy Wonka and the Chocolate Factory shrunk down to a retail store," he says.

In 2011, Whaley tested the new concept through two licensing agreements, a form of partnership that has fewer legal requirements. Soon after, two Chocolate Works opened, in Manhattan and Scarsdale, New York.

After those units proved successful (one did $800,000 in sales its first year), Whaley hired an experienced team to help turn Chocolate Works into an official franchisor.

Whaley reports the first franchise sold in just a few months. Including the $50,000 franchise fee, a typical franchisee spends roughly $350,000 to open a store, depending on local retail lease costs. Several early franchisees have already purchased additional franchise locations, Whaley says, including one Missouri franchisee who signed up last May to build four more units.

From its 2013 franchise debut, Chocolate Works now has 20 stores operating and 19 more franchises sold, in New York, New Jersey, Connecticut, Missouri and Pennsylvania. The main factory has tripled in size to keep up with franchisee demand.

What tips does Whaley offer would-be franchisors? "Make sure you hire the right people and have a solid concept before you franchise," he says. "We started with just chocolate, but added candy and ice cream, as we tested Chocolate Works out."

> "I MAY BE THE HEAD COACH, BUT A FRANCHISE NEEDS A GREAT COACHING TEAM AND GREAT PLAYERS."
>
> —DAVE WOOD, CEO, FIRENZA PIZZA

2. IS YOUR IDEA UNIQUE?

There are roughly 3,000 different franchise offers that prospective buyers can choose from today, says Libava. To attract those critical first franchise buyers, your idea will need to stand out.

The Gents Place has that going for it since there isn't a national chain of day spas for men as yet. Simply hopping on an established trend—say, opening a new frozen yogurt brand—is unlikely to succeed, he adds.

If your idea isn't new, putting a fresh twist on an existing business type can work well. That was the case for Dallas-based HomeVestors, the home fixer-upper network that began franchising in 1996 and shot to success with its "We Buy Ugly Houses" slogan and "Ug" caveman mascot. The company has franchise locations in 44 states and will buy more than 8,000 houses this year.

Virginia-based Firenza Pizza, which began selling franchises in late 2015, stands out from other pizza chains by offering unique topping options such as asparagus and avocado slices. "One of the [other] ways we are different from other pizza chains is the interactive control we give the customer," says CEO Dave Wood. "There is no guessing how much pepperoni the customer wants—the customer tells us as we make the pizza."

The concept is working. "We have reached agreements with great franchisees to open over 60 locations over the next few years," Wood says.

3. IS THERE A SYSTEM?

To sell franchises, you'll need every aspect of operations documented to make it easy for owners to follow and to create consistency. Franchise buyers expect to review these materials when they evaluate your concept.

For Chocolate Works founder Joe Whaley, that meant creating a 1,200-page operations manual describing everything from how to use candy-making equipment to how goods should be displayed.

"We had to put everything we did on the fly, that was in my head, onto paper," Whaley recalls. "Which Pantone colors we use, all the molds and recipes, how to temper chocolate, where to get your packaging, our approved suppliers—every single aspect has to be in there."

Training methods also need to be standardized so that customers have a similar experience and are treated in the same way, no matter which unit they visit.

At pest-removal franchise Mosquito Joe in Virginia Beach, Virginia, CEO Kevin Wilson says they've developed more than 20 hours of recorded orientation and training videos they post online for prospective franchisees and another 50 hours of training is delivered live at headquarters.

To help develop these systems, most companies, if they have no past franchising experience, hire franchise pros to assist them. Mosquito Joe's Wilson—who was the founder and CEO of franchisor Benny's Bagels and also previously owned a CiCi's Pizza franchise—was recruited to get Mosquito Joe ready to sell franchises in 2012. He hired an executive team with similar experience, to create support services for the franchise owners.

"We have 80 years of cumulative franchising experience on this team," he says.

4. HOW WILL YOU FUND IT?

Turning your business into a franchise is a costly process. The legal paperwork alone can cost $15,000 to $25,000, says franchise attorney Harold Kestenbaum, who's the co-author of *So You Want to Franchise Your Business*. Besides the FDD, you'll need to register with each state where registration is required to sell franchises. That's just the beginning of the expenses new franchise chains typically see.

"Being undercapitalized is one of the great downfalls of companies that want to franchise," he says. "Often, they'll pay my fee and have no money left for marketing."

Franchisors need marketing help to sell the franchises, additional office staff to assist franchise owners, corporate trainers and more. Then, if you're lucky, it'll be three to six months before you see the first franchise-fee check, says consultant Libava.

To ready its chain for franchise sales, Mosquito Joe raised $3.5 million from a pool of 50 investors, including Wilson. The company now has nearly 170 locations open, with 100 more franchises sold.

The Gents Place's Davis went a different route, raising just $400,000 but putting two key partnerships in place to help launch the chain. He brought on The Elevated Brands—which operates the 150-unit massage and facial franchise Massage Heights—as one partner, and Pro Football Hall of Famer Emmitt Smith, a Gents Place member, as company spokesman.

The move allows The Gents Place to take advantage of franchise sales and support and training staff that Elevated already has in place, saving greatly on up-front spending, Davis explains.

5. HOW WILL YOU PROMOTE IT?

Once you're legally set to sell franchises, there's the challenge of getting noticed in the crowded field of franchise offers. Franchise-sales staff will prospect, often among successful franchisees of other chains, who may be looking for additional brands to add.

Beyond that, media attention can help a new franchise brand reach more potential franchise buyers. For instance, Davis of The Gents Place says he's hoping that Smith's celebrity status will help attract positive press.

Hiring public relations help made a big difference when the pet-care chain Camp Bow Wow launched. President Christina Russell says publicity got them a prime "company story" ad spot on the home page of AOL. More than 3,000 franchise leads poured in as a result, she says, as many as the chain usually sees in a year.

At HomeVestors, the company attracts media attention by holding "ugliest house of the year" contests and giveaways of fixed-up homes to deserving persons such as veterans, says co-president David Hicks. Whenever the company enters a new market and those "We Buy Ugly Houses" signs go up, articles and TV coverage usually follow, as newcomers to the brand seek to understand what's behind the catchy slogan.

One important way you can stand out from the pack and attract better franchisees is with strong financials. Strive for higher profit margins or a faster return on investment than other franchise chains in your sector, says John Reynolds, president of the International Franchise Association's Educational Foundation. He recommends reading competitors' FDDs and analyzing their profit margins and fee structure.

"You need to understand what the marketplace is offering," he says, "and then make those franchisees a better offer."

6. READY TO BE IN A NEW BUSINESS?

When you have a successful business, you've already mastered the art of, say, making pizza or how to efficiently do people's taxes.

As a franchisor, you're in a new business—the business of making your franchise owners successful, notes IFA's Reynolds. You need to help those owners grow sales. "There's nothing in common between flipping burgers and supporting franchisees who flip burgers," Reynolds says.

You can make your new role easier by choosing franchisees who are a good fit for your organization. "You don't want to take anyone as a franchisee who you wouldn't want as a partner 10 years from now," says Camp Bow Wow's Russell, noting that's the term of a typical franchise agreement.

Choosing early franchisees carefully is important, because it's critical that initial franchisees succeed, Libava says. Most franchise buyers want to talk to existing franchise owners—so those first owners need to be happy and successful or your dreamed-of franchise chain may never get any traction.

Since your first franchisees won't be able to talk to existing franchise owners, you'll need to sell them with the personal touch, says Libava. These are entrepreneurial types who're willing to take a risk on your budding business idea. In return, they'll expect more face time with top managers and input into the brand's development.

If you're used to being the boss and calling all the shots, prepare to learn collaboration skills, says Libava. It'll be worth it: Franchisors who listen to early feedback often gain valuable new ideas for growing revenue.

For instance, the idea for the "ugliest house of the year" contest at HomeVestors came from a franchisee, says co-president Hicks. A new iPad app the company introduced that lets franchisees evaluate a home's profit potential and its repair needs on the spot was also a franchise owner's suggestion. "Most of our good suggestions come from franchisees," he says.

Besides taking their suggestions, be prepared to offer extensive, ongoing training and support to make sure your owners succeed. New franchise owners at Mosquito Joe are assigned a business coach who works with up to 25 company franchisees, says CEO Wilson.

Successful HomeVestors franchisees can apply to become "development agents," who provide support to new franchisees through ongoing training and advice. "We pay them to support the

FRANCHISOR RESOURCES

Interested to learn more about becoming a franchisor? These resources can help.

The International Franchise Association:
franchise.org

FRANdata:
frandata.com

EDGAR:
sec.gov/edgar/searchedgar/companysearch.html

Publications and websites:

FRANCHISE UPDATE
www.franchising.com/franchisors/magazine.html

FRANCHISE TIMES
franchisetimes.com

BLUE MAUMAU
bluemaumau.org

Books:

So You Want to Franchise Your Business by Harold Kestenbaum

Franchise Your Business: The Guide to Employing the Greatest Growth Strategy Ever by Mark Siebert other franchises," says co-president Hicks. "We have a company culture where our franchisees like helping each other and want each other to be successful."

For business owners who are used to controlling every aspect of operations, it can be tough to let go and allow franchise owners to manage their locations as they see fit. But leaving room for owners' creativity is a key to franchise success.

7. HOW DO YOU DEFINE SUCCESS?

For business owners who look at Five Guys' success and dream of creating a huge national chain, the reality of a typical franchisor's more modest success may be disappointing. Most will never hit 100 units, says attorney Kestenbaum. But a regional chain that has hometown appeal can be lucrative and easier to manage.

"I have one client in Tampa in the pizza business," he says. "He's got 50 franchisees, and he's not interested in going outside Florida."

For many entrepreneurs, the point of building a franchise chain is to build the system and then cash out. Two years ago, for instance, Camp Bow Wow was acquired by animal-hospital operator VCA Inc. The sales price wasn't disclosed, but at the time, systemwide sales at Camp Bow Wow were $71 million.

If the odds seem long on successfully turning your business into a franchise chain you could sell for big money, that may be a good thing, says IFA's Reynolds. Hopefully, that encourages business owners to keep working on their profit margins and refining their concepts until they've got the capital to make it through the initial years of trying to build a franchise brand.

"Franchising is not a get-rich-quick scheme," he says. "And it never was."