

Is Franchising Right For You?

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You can hardly go through any town in America without passing by a franchise. Whether that's a service station, a fast-food restaurant, a hotel, or any one of the 851,000 franchised units, franchising has grown to become one of the dominant models by which we distribute goods and services[1].

Over the past decade franchisees have evolved from single-unit operators, to operating multiple units, to operating multiple units with multiple brands (MUMB). While most of the business world is fixated on AI, franchisees are quietly building empires.

In this article we hope to demystify franchising from the franchisee's perspective and suggest that franchising can be used by people in multiple ways that allow them to create the business they want.

What is a franchisee and why would you ever want to be one?

You can think of a franchisee as a mid-point between an entrepreneur and an employee. A franchisee will take some risk, like an entrepreneur, but will have far more discretion in the operation of their business than an employee. The best part of being a franchisee is that you are in business for yourself, but not by yourself. That's a cliché and selling point in the industry, but it's true. It takes a certain type of entrepreneur to become a franchisee.

- If you want a steady paycheck, benefits, and predictability in what you do, you're better off as an employee.

- If you are clearly innovative, seek to disrupt business models, and prefer to fail trying your own methods rather than follow a proven system, franchising is not a good choice for you.
- If you're the type of person who wants to change everything -- if you think, "I can do this better," -- then don't buy a franchise. An exception is if you buy a struggling unit of a franchise and aim to make it profitable again, but you still need to play within the franchisor's rules.

You buy a franchise to follow the model; to implement and to execute a proven system. You leave innovation to the franchisor. You let them improve the model and change the product mix, change the menu, or upgrade the technology or other aspects of the business. If you have ideas and input, provide those. The Egg McMuffin was created by a franchisee who said, "Hey, this is working for me." Corporate managers at McDonalds picked that up, systematized it, and rolled it out to the whole brand.

While a lot of the best innovations come from franchisees, franchisees should not feel obligated to innovate. Their responsibility is to implement and execute the whole model -- the whole thing, not parts of it or the parts they like, but everything.

A franchisee is an owner and an operator

Unlike an entrepreneur or employee, a franchisee owns and operates whatever they buy in their market, whether it's location-based, home-based, or mobile. They operate and own that unit, but it's not only their business; it's a business based on a model. Franchisees receive training, learn about operations and marketing, vendors, financials, and management. They will learn about all the different components that go into a franchise. If you're the franchisee, it's your investment, your money, your opportunity, your risk,

your liability, and your responsibility.

Like all business owners, franchisees are self-employed and probably put themselves on the payroll. If they're lucky and have some cash flow, they can eventually pay themselves. They also get the joy of discretionary spending. That means they can choose what costs to put through the business, plus they'll get tax depreciation and amortization. You don't get any of that as an employee.

Buying a franchise will cost more than starting by yourself as an independent operator, but statistically franchising is lower risk. Another advantage is that it's a lot easier to exit as a franchisee versus an independent operator, because a franchisor is going to help facilitate and sell that unit to the next buyer. The franchisor has a stake in the continued success of that unit and will train and support the buyer to make sure that business stays competitive.

Should you Buy a New Unit or an Existing Unit?

Buying a new franchise unit is not the only way to get into the business; there are other paths that might be more profitable, depending on your skill set. For example, lots of existing franchisees are unsuccessful for whatever reason. Life changes -- people get sick, people get divorced, people need to move -- and some of them need to unload their business. That's an opportunity for someone to buy a distressed unit and bring it up to standard. We know of people who bought a unit that was struggling, went through the training, followed the franchisor's model, brought the unit back to profitability, and sold it. If you can put in a tremendous amount of effort, it can be a wildly successful return on an investment of time and money.

Some people actually seek out those struggling units. They'll go to the franchisor and ask, "How many of these do you have?" And the franchisor might say, "Well, you found that one, but we've got 10 more over here and there's a couple over here and there's a bunch over there. And we want to fix up all these units." So, there are people who will come into a brand, look for the ones that are struggling, buy them, run them, clean them up, and then sell them. They'll then go do it over and over again.

It's not as easy as it sounds, because you have to know what's wrong with the unit when you're buying it. And

even then, can you make the corrections? Fortunately, franchisors often give the buyer or the franchise seller an assessment of where things stand: Here's what you need to correct; these are the things where you're deficient; or here's where you have scored low on our assessment. So, if you're the type of person who likes to fix things rather than start things, there are plenty of opportunities to do that. And while fixing something can be a bigger opportunity than starting something, nothing's easy.

If you want to fix an existing unit, our advice is to look for the best opportunity in a sizeable, brand-name franchise. You don't want to buy a troubled unit of a brand that has only 10 units. Instead, look for one in a brand that has 500 units. In a large brand you'll have momentum around the concept, and the exit is easier.

From One Unit to Many

If you're good at starting things, being a multi-unit franchisee could work for you. When you buy a unit, you're 100 percent focused on that business: Open it, get it to cash flow, grow the business. Once you've proven that the model works and you're good at it, then you can consider becoming a multi-unit franchisee.

One caution: don't overcommit upfront. A lot of brands, especially if they are a lower investment, will say, "Well, we'll sell you three, because that's the scale that it takes to really be a high performer." That's a dangerous position to be in if you've never operated a franchise in that brand, because you're over-committing to something you don't even know. Commit to one unit, give it time and attention, and then expand beyond that. Incremental growth is better than over-committing.

We know of a person who was very motivated to be a multi-unit owner and the franchisor told him he needed to own five units to get the level of income he wanted. It turned out that no other franchisee owned that many units. Moreover, the franchise was owner-dependent. Most of the owners worked in their business every day, all day long, and they didn't have the revenue to support a full-time manager. You're never going to get to five units if a franchise doesn't support a manager-operated model. So, don't buy one thinking you're going to make it work when no one else has made it work.

Rather than buying five units at once, this person opted to buy the five units one at a time. He made his money by making each unit profitable and then selling it to

someone else before buying the new unit and installing his manager there. With this approach, you can pick a site, build a new unit, crank it up to cash flow, and then sell it to the next owner who doesn't want to do a startup but instead wants a cash-flowing business out of the gate.

This person made more money selling his franchises than he would running them. He could build and sell them about every 18 months and make \$100,000 to \$200,000 on each transaction.

That's how you're going to get the ROI that you're looking for -- not by operating them long-term, but by building them to sell and getting good at that. The franchisee did five of them and then got out of the business, but he never had five at once. He had five in sequence.

Multi-unit, multi-brand

Today, we're seeing a lot of franchisees develop one unit, get that unit profitable, and use excess reserves to start another unit. This not only changes the risk that franchisees take for a specific location, but also allows them to create equity.

If you want to reduce your risk even further, you can develop units in multiple brands. It takes a lot of capital to do that, but the rewards are that you can learn the best practices and get different perspectives from multiple franchisors.

We know of a person who owns every franchise at the busiest intersection on the Ohio Turnpike. Need gas? You'll be going to his service station. Need to spend the night, or grab something to eat, or shop? He's got you covered. This is a massive operation with a lot of moving parts, but once you figure out how to be successful as a franchisee, there are multiple ways to generate returns.

Have it Your Way

Franchising is no longer the Mom & Pop single store where the owners toil in the business for hours on end, day after day. It's possible to be a turnaround specialist, to be a person that develops stores and then sells them. It's also possible to own multiple units, or own multiple units in multiple brands. Or, you can go the other way and create a lifestyle business, and set the income you want and the hours you want so that you have control over your time. There is much more flexibility in

franchising and more opportunities for people to be involved in the way that they want.

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[1]

<https://www.franchise.org/franchising-economic-outlook/>. This data comes from the Association promoting franchising so is most likely optimistic. We use the figure of 800,000 franchised units in the United States as a more conservative estimate.