Is Franchising the Right Expansion Vehicle for Your Restaurant Brand?

By Rochelle Spandorf © 2021

If you are a successful restaurant owner with a catchy logo and crave-worthy menu, undoubtedly your customers have asked you, "How can I own a business exactly like yours?" Restaurant brands across all market segments grow their footprint by awarding franchises. Why? Because franchising allows a restaurant owner to expand by using other people's money (the franchisees') and earn revenue off their franchisees' top line. Franchising solves the two biggest roadblocks to any business expansion: capital and labor.

Franchising offers restaurant owners numerous advantages for fast-tracking their brand's growth: access to capital without taking on debt; rapid propagation (multiple franchisees can develop and open units simultaneously); and labor solutions (your franchisees hire, train and supervise workers, not you). Franchisees, in turn, gain the freedom, satisfaction and flexibility of being their own boss and profiting from their own efforts.

Franchising may not be an appropriate expansion strategy for every restaurant owner. How can you determine if franchising is right for you?

Here are 10 important questions to consider:

1. Is your current business easy to replicate? By awarding a franchise, you allow an independent business owner to hitch its wagon to your star, i.e., your brand name and reputation. Because the reputation of your brand depends on being able to deliver a consistent consumer experience, your restaurant concept needs to be easy to duplicate by different independent owners. Replicability is important not because franchising stifles a franchisee's creativity (it does not), but because a brand's reputation depends on consistency. If the personal touch that differentiates your brand is having an Escoffier-trained chef supervise every plate that leaves the kitchen, franchising your restaurant concept may expose your brand reputation to too much risk.

2. Is your current business profitable? Franchisees that fail to make a living are the leading cause of conflict in franchise relationships. The acid test of a successful franchise is return on investment. Restaurant franchisees (particularly private-equity backed ones) generally expect an ROI of at least 15% by the end of the third year of operation. While franchisors do not guaranty results, concepts that deliver the expected ROI attract the best franchisee candidates. If it has taken years for your restaurant to turn a profit, imagine the challenge a franchisee faces eking out a profit after paying you royalty and marketing fees. If your current business model has not yielded the kind of profit that restaurant franchisees expect after a two-to-three-year ramp-up, franchising may be the wrong expansion choice for your brand.

3. Are you ready to step into a new business? Being a franchisor is a completely different business than owning a successful restaurant. A franchisor's business is to sell and service franchises. Consequently, launching a franchise program puts you in the business of recruiting and motivating independent business owners; championing the brand for the benefit of all licensees; teaching others how to replicate your business model; introducing new menu items and other innovations that give customers reason to return to branded outlets; leveraging the network's scale to deliver benefits to franchisees that they cannot individually attain on their own; offering a support structure to supervise franchisee operations; protecting system standards against rogue operators that could damage the brand's reputation for everyone; and continuing to do all of this for as long as any franchisee has time left on its franchise agreement. Franchisors are not in the restaurant business; they are in the people business.

4. Are you ready for a long-term relationship? Franchise agreements generally award franchise rights for 10 years or longer, often with renewal options, recognizing the time it takes to generate a return on investment. Some franchisors reserve a "call" option to hedge their bets against a long-term commitment. However, unless if the contract calls for paying the franchisee a true, fair market value "buy-out" price, a below-market call option just makes the franchise program less marketable.

5. Are you willing to invest in a well-thought-out franchise program? New franchisors chronically underestimate the cost to launch a franchise program. Franchise business consultants recommend setting aside from $150,000 to $200,000 to cover the cost to engage a business consultant and legal team to prepare a franchise business plan; write the franchise disclosure document (FDD) and legal contracts; prepare a comprehensive operations manual; prepare financial statements for the new franchisor; create lead generating solutions; and court prospective franchisees. A rookie mistake of new franchisors is assuming that FDDs are nothing more than generic boilerplate and they can launch a franchise program on a shoestring by copying a successful franchisor's FDD (FDDs are public documents). It's usually takes just a few years until these rookies discover that they have committed themselves long-term to a franchise program and fee structure that does not work for their restaurant model or cost structure.

6. Are you a control freak? If you have an autocratic management style, franchising may not be right for you. Franchisees are independent entrepreneurs. While they are contractually bound to follow your business methods and operating procedures, neither they nor their employees are your employees. If you treat them like they are your employees, you expose yourself to new legal risks and potential conflict.

7. Do you have protectable IP? Even if you never franchise, you should protect your restaurant's name and logos by registering them with the U.S. Patent and Trademark Office (assuming they have at least nominal distinctness). If you do franchise, then your IP portfolio should include a deeper IP platform with specialized recipes or ingredients that you keep secret, as this will sustain a franchisee's loyalty to your brand. As long as your IP provides a positive point of differentiation, it will give franchisees more reason to expand their investment in your brand. A franchisor's easiest next franchise sale is always to an existing franchisee.

8. Do you have a credible organization? A common mistake of start-up franchisors is assuming that they can continue to give their own restaurants the same degree of personal attention and launch a franchise network at the same time without adding new management to their organization. New franchisors that try to juggle both rarely succeed in franchising and often see their existing business suffer. Successful restaurant operators need to absorb several new jobs related to their franchisor role for which they likely have little to no training, time or experience: franchisee recruiting, lead handling, franchise sales, training, contract supervision, franchise sales legal compliance, and launch supervision. Start-up franchisors can also be blinded by the attraction of collecting large initial franchise fees upfront when a new franchisee signs a franchise agreement. However, smart franchisors know that the real money from franchise relationships comes from continuing royalty fees paid by franchisees after they open. Consequently, smart franchisors design systems that eliminate delays and hiccups in the site selection, buildout and training phases so that franchisees are able to open their franchise restaurant as quickly as possible after signing a franchise agreement. Smart franchisors accomplish this by offering their franchisees access to leasing specialists, architectural and design services, pre-built fixtures and equipment packages, and preferred vendor buying programs. Your existing infrastructure may be stretched too thin to absorb the extra support required to launch multiple franchisees at once especially if you have never yourself grown beyond your original restaurant location. Foremost, do not assume that you can sell franchises, onboard new franchisees, and tend to your own restaurants – and do each well simultaneously - all by yourself.

9. Does your existing portfolio include a suitable prototype? Prospective franchisees want to "kick the tires" and see for themselves what their franchised restaurant should look like. If you need to adjust your current restaurant model in order to package a franchise program, open the prototype first. A well-run prototype will help you sell franchises. It can serve as your training facility for delivering hands-on training to franchise owners and their managers. A prototype also supplies a place where you can test new recipes, technology, delivery systems, marketing techniques, and other operational changes before you ask franchisees to invest in change. A franchisor should never mandate that franchisees adopt untested programs unless the franchisor is able to make a business case for why they work.

10. Can you communicate your operating procedures in a way that others can follow? All successful businesses have systems and procedures. Not only must your model be replicable, but you also need to be able to document the distinctive attributes of your model in a way that communicates the details effectively so that your franchisees understand what they need to do. Your brand's reputation depends on having a teachable program.

Numerous resources explain the obligations of a franchisor. Tap into your networks for introductions to restaurant franchisors willing to share why they chose this expansion vehicle and how they launched their program. Seek out the advice of a knowledgeable franchise business consultant and an attorney specializing in franchise law. If franchising is right for your restaurant concept, by doing your homework thoroughly, you will be able to jump in without hesitation.

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