Understanding Franchising

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For the past twenty-five years the key concepts of franchising have been under going evolution and transformation. Management 2000 has had the good fortune of being in the middle of those developments. This involvement has helped us understand the importance of these concepts for franchise companies. It has resulted in our commitment to helping companies understand franchising so its full power can be unleashed. The purpose of this article is:

1. To establish *unified thinking* about franchising and the language that must reflect that understanding.
2. To identify how a company can use franchising as a strategy to accomplish its Mission.
3. To recognize the implication of these changes for companies that franchise and for their franchised partners.

Unified Thinking

Since it's my own business, I can do what I want with it. I'm the best judge of knowing what I ought to do.

This seems logical, doesn't it?

However, such a response in a franchised organization is the result of a misunderstanding of franchising, which is often the root of many of the problems that beset franchise companies today.

To be successful in a franchise system, all those involved, the home office, its staff, the franchise and its employees, must have a collective understanding, that is, *unified thinking,* about franchising, what it is, why it is, and what it seeks to accomplish.

Purpose of Franchising

Franchising is a marketing and distribution system. Sometimes the system distributes a product. Sometimes the system delivers a service. But always the product or service is delivered as an experience to the customer. Always it results in customer perceptions of whether or not they want to do business with you again and whether or not they will speak well of you resulting in new customers.

Individual, independent companies also deliver products and services; but the strength of franchising is in numbers:

1. The more products and services that are delivered under the same name, the same Brand, the greater the consumer recognition.

2. The greater the name recognition, the more likely the consumer is to use or patronize that Brand or service when they have a need.

3. The more likely consumers are to use a Brand name product or service, the faster that Brand can capture the market (increase market share).

Purpose Of Business

If you were asked,

What is the purpose of a business?

You would probably say,

To make money, or *To make a profit.*

But money and profit are the *result* of something else. That “something else” is customers. That’s the purpose of business: To get and keep customers. Thus, it can be seen, the purpose of franchising and the purpose of business are the same: To get and keep customers.

Purpose of A Franchise Company

A company’s Mission Statement defines who and what it is, why it is in business. An example of a Mission Statement is:

To Win Customers For Life

Thus, it can be seen, the purpose of franchising, the purpose of business, and the purpose of a franchise company is the same: To get and keep customers.

Function of Brand

Brand repetition is a critical requirement for creating a real or perceived image in the minds of consumers about what a Brand name stands for. (McDonald’s knows this. According to *Nation’s Restaurant News,* they spend $3.2 million *a day* on marketing.)

Franchisees don't automatically perceive that widespread availability of the Brand promotes their own interests. They are more likely to see it as advancing the company's interests, rather than their own. But if you understand the marketing objective that is, capturing market share, then, rather than viewing fellow Franchisees as competitors, you can see each one as a strategic-partner committed to establishing the company as the dominant Brand in all markets entered. Focusing on the marketing objective of franchising lets you cultivate an understanding of 'growing" the company system wide. By increasing consumer awareness, when customers need or want to buy, your company is at the top of their minds. This is how the Mission Statement is fulfilled. Retention is increased, frequency increases, customer satisfaction is raised and referrals are made; sales are made; and everyone enjoys a greater return on their investment.

Function of the Operating System

Because of Brand recognition, customers develop certain expectations, about the quality of the product, the caliber of service, the professionalism of the staff, and so on. The objective for a franchise company is to meet these expectations by managing them. Every time. The way they do this is through consistent application of the same operating system, wherever a unit is located.

An operating system is a way of doing business that, over time, proves (or disproves) it can work. When everyone in the system, everywhere in the country, is following the operating system, the public's experience is reinforced. They come to understand there will be no surprises when they buy. They know they'll receive the same quality and service, no matter which office they call, or store they shop, or service they buy.

It is in every franchise's best interest to observe the operating system, every time. Not just the first time, or not just until they "have it down," but every time, not for *their* sake, but for the *customer's* sake, because it fulfills the buyer's expectation. Following the operating system increases the value of the Brand because every time a customer has an experience with it, it's positive.

It is also important that within the franchise system, every franchise has confidence that everyone *else* in the system is conducting business in exactly the same way, so anyone who uses your services, no matter where they are located, has the same experience with every Unit they frequent.

Importance of Language

Language shapes behavior. That means, the words you use reflect the way you think. The way you think determines how you act. The language used to discuss business and franchising shapes the relationship between the Franchiser and Franchisees.

Franchisees don't *own* the franchise. *They are licensed to use* the Brand and operating system for a period of *x*-number of years. In fact they are not just licensed to use in the sense of an option to use but in the sense of being obliged to use. When you hear words like *buy*, *sell*, and *own*, be careful. It's *sales* talk. Most of the literature you read also uses this selling kind of terminology. But let's explore the effects of the "buying" and "selling" language and look at its impact.

- If I sell you something, that means you bought it.
- If you bought it, you own it.
- If you own it, you can do what you want with it.

Effect on the Operating System

These "buy" "sell" words create an "owner" mentality. Once someone believes they "own" the franchise, it leads them, understandably, to believe the business is theirs to do with what they want. Included in, doing what they want, often means making changes in the operating system, which, in turn, distorts the company's whole purpose in having a franchised organization in the first place.

Effect on the Brand

The "owner" mentality has other effects, as well. It leads people to believe that because they "own" the franchise, everyone else is a competitor, not just the true competitors, but fellow Franchisees as well! This distorts another purpose of having a franchised organization, widespread name recognition for purposes of market dominance.

Effect on Field Support

If Franchisees believe they are independent, and independent "owners" at that, they don't see themselves as a part of a whole. Since they don't see themselves as part of a whole, why should they care what others are doing? Why should anyone care what *they* are doing? Compliance is not an issue for the Franchisee. It's only an issue to the Franchiser.

Of course, this approach puts the field staff at a distinct disadvantage. It obliges them to come to terms with Franchisees about how they should be "running" their business, the very business the Franchisees believe *they* own!

> Understandably, Franchisees become resentful. They feel,
>
> *Who **is** this guy? What is he doing in **my** store? How can he possibly know what I should do to run **my** business?*

Who Owns What?

Franchisers---yours included---cannot "sell" a franchise. Franchisers grant *licenses* to Franchisees, much the way the state grants you a license to drive. It is very instructive to look at the concept of *things licensed*: lawyers, doctors, pilots. All licensed. Why are they licensed? The licensing body when they issue a license has a minimal assurance the customers of the one licensed are either protected or assured of a minimally correct product or experience. All licenses have certain things in common. They are: for a specific period of time, renewable, not able to be sold without the licensing body's approval, involve systems to follow, initial training, and most importantly the goal of licensing is to fulfill the goals of the licensor. The goals of the one licensed are not the primary concern of the licensor. If they get what they want and need as licensees so much the better.

The fact that a franchise license is not sold and the Franchisee does not buy the license is supported by the following facts:

- A Franchisee cannot incorporate using the Franchiser's name because the Franchisee does not own the name.
- Should the Franchisee want to exit the business, the franchise license is not sold; rather, the franchise license is transferred upon approval of the franchiser. The Franchisee enters into a separate transaction to sell the assets of the business (such as the equipment).
- The franchise agreement has a stated term and must be renewed if the Franchisee is to continue in business under the franchiser Brand name. If a Franchisee owned the license, it would not need to be renewed.

The franchiser owns these things: The Brand name, the operating system and the markets they select to enter. The franchisee owns their company. But instead of operating it as an independently branded unit, chooses instead to use a dba, your name. For a fee, the Franchisee is *licensed and obligated to use your Brand name and operating system in a defined and proscribed way, in a defined market, for a designated period of time, to develop market share for the franchise system and to accomplish your business goals while pursuing their own personal and business goals through the investment they've made.*

Franchisers have lost sight of this entirely.

In theory the Franchisee, using the Brand and operating system, is able to get and keep more customers and, thereby, increase revenues, more than they could had they not used the Brand name and the already-established operating system. In other words, they could have hung out a shingle saying "Karl's Karpet," but they will probably do better using a recognized name like yours.

If a franchisee doesn't own the franchise, just what is the relationship with the Franchiser? The franchisees are strategic-partners (partners in ***your strategy***) in an interdependent relationship in which both work for the same business objective, which is to dominate markets by getting and keeping customers. They are self-employed and in business with your company's marketing and operating philosophies, strategies and systems. These include an operating system, a Brand name that has value in the consumers' eyes and ongoing support to help build the business.

Although the Franchisee is ultimately accountable for the decisions made that determine the success or failure of their individual investment, the Franchiser provides them with resources (time, people, and material) to help them think the way they need to think to make their investment successful.

The Franchiser's success is coupled with the strategic-partners consistent delivery of the operating system. The strategic-partner's success is coupled with the Franchiser's continual improvement of the operating system, staying tuned to what customers want, conducting research and development, strengthening Brand awareness, and providing competent support services to help them build and grow their business.

Understanding Fees

Without the correct understanding of franchising, it is easy to be unclear about the various fees. Unless a clear purpose is perceived, Franchisees conclude there is *no* purpose. Understanding the fees is another area that requires unified thinking among candidates, new Franchisees and long time strategic-partners.

Initial Franchise Fee

The initial franchise fee is placed in a general fund and used to pay some of the expenses of the business operation, all of which, and this is a key point, protect the Franchisee's investment:

- The expense of selecting quality Franchisees who will work hard to develop the Brand and grow the system.
- Initial training of Franchisees so they understand what it means to profitably operate their business, which ultimately contributes to the profitability of every other franchise.
- The ongoing legal expenses involved in protecting the integrity of the franchise, including registering and protecting the trademark and trade name.
- Accounting fees.
- Conducting ongoing research and development of new products and/or services.
- Opening marketing assistance.
- Employee salaries and benefits.

- General and administrative expenses.
- Field Consultations.

Royalty Fees

The true reason for royalty fees is one of the most misunderstood aspects in all of franchising. Franchisees often believe royalty fees are paid for the ongoing support supplied to them by their Consultant and the company. They mistakenly take this as an indication of a guarantee that the company and Field Consultant will make them a financial success. They look on the franchiser as their vendor; "what are you doing for me lately."

Sooner or later, however, the Field Consultants start to look like the most expensive consultants the Franchisee has ever known, either because the Franchisee perceives they are no longer needed or because the franchise isn't making enough money to warrant having them. As long as Franchisees have this perception about the purpose of the royalties there will come a point at which, no matter what or how much the Coordinator does for the Franchisee, it's not enough. This does harm to the long-term Consultant/Franchisee relationship.

Let's look at the real purpose of the royalty fee specified in the franchiser franchisee agreement. Royalties are paid because the franchises, both system wide and locally, are able to generate revenues during the period just ended, due to:

- The Brand's ability to drive customers to the units
- The Operating System's ability to satisfy customers and help the franchisee to operate efficiently and effectively
- The training and support and vendor systems which allow economies of scale and savings

Think again of McDonald's: If there were some small hamlet in some small state that had *no* McDonald's, and a sign appeared saying, "McDonald's Coming," what would be the effect on that potential Franchisee's business? Customers would be lining up (in their minds) even before the restaurant broke ground! That's the power of system wide Brand recognition.

The franchise agreement states what the royalty is and when it's due. There is no statement connecting the royalty with any services provided, because that's not what it's for. This royalty does not come from the franchisees' money. The franchiser's and the franchisees' money comes from the customers. The customer pays both parties. The franchisee does not pay the franchiser. The franchisee remits part of the customer's money to their strategic-partner, the franchiser.

Customer-Driven Company

The last area of unified thinking among Franchisees, and the most important one to your future success, is in creating a Customer-Driven culture.

The best franchise company will realize the key to its success lies with making the customer experience the center of everything it does. A Customer-Driven company (Disney, Ritz Carlton, Nordstrom's, Saturn, Mercedes, British Airways, ServiceMaster, CitiCorp, Southwest Airlines) understands their only security in the future is the customer and their perceptions of the service experience. To this end there are emerging new key operating ratios. These new operating ratios make measurable the customer centered philosophies that emerged in the 1980's and 1990's. These will replace, in importance, existing key operating ratios. These new key operating ratios are possible because of technology. Here they are:

- The number of new customers system wide and at each unit
- Customer retention ratios for the system and each unit
- Frequency of customer purchases for the system and for each unit
- Customer satisfaction ratings for the system and for each unit
- Average sale system wide and for each unit
- Referrals from satisfied customers for the system as a whole and for each unit
- Employee turnover
- Employee satisfaction
- Franchisee satisfaction
- Market share

Some of these are being used but no one company is using all of them. In twenty years all successful companies will be using all of them.

These key ratios will be used to determine who gets to open more units and who will be defaulted. Everything will be focused on the customers and those things and those people that affect whether or not the customers continue doing business with your company.

In the future franchisees will work together to dominate markets, evaluate each other and plan together on how to capture more and more customers. Management by objectives will become common place among franchise companies. Individual franchisee plans will roll up into market and ADI plans. These in turn will roll up into Regional and Division plans. The company will have a plan and no longer held hostage by incorrect paradigms of franchising propagated by those who think franchising is about making money selling franchises.

A Customer-Driven company realizes the key to its success lies with its referral sources, the customers. The Customer-Driven franchise company understands being Customer-Driven means creating a customer experience that manages the customer's expectations and therefore their perceptions of the brand. Franchising is the best strategy for accomplishing this that exists.

The franchiser needs to continually examine the activities and procedures that demonstrate a willingness to serve customers. If *we* don't take care of the customers, someone else will.

The Field Consultant role will be to continually encourage franchisees to see that being Customer-Driven means everyone on the team has *an attitude and a belief that we will not be satisfied until everyone who wants and needs our products and services is being satisfied.* It also means:

1. Their customers (our customers) are the most important people in the company.
2. The customer is not dependent on us, we are dependent on the customer. We work for the customer.
3. The customer is not an interruption of our work. The customer is the *reason* for our work.
4. The customer does us a favor by using our business. We are not doing the customer a favor by being of service to them.
5. The customer is as much a part of our business as anything else, including our employees or facilities. If we sold the business, the customers would go with it.
6. The customer is not a cold statistic. The customer is a person with feelings and emotions, just like yours. Treat the customer *better* than you would like to be treated.
7. The customer is not someone to argue with or match wits with.
8. It is our job to satisfy the needs, wants, and expectations of our customers and, wherever possible, allay their fears and resolve their complaints.
9. The customer deserves the most attentive, courteous, and professional treatment you can provide.
10. The customer is the lifeblood of our business. Always remember that without customers, we would not have a business. We work for the customer.

When everyone in the company is thinking, speaking and acting as if the customer experience is the center of their universe, that is ***franchising at its best,*** a Customer-Driven company poised to finish out this decade as a strong, successful franchise system.