FUTURE OF FRANCHISING

Forward-thinking Strategies to Build a National Brand

Joe Mathews, CEO, Franchise Performance Group

INTRODUCTION

Summary of this work

The Future of Franchising is a robust state-of-the-industry overview of franchising best practices and key foundational brand pillars. We give a brief history of franchising and how the market-forming effects of the past shaped modern franchising and will predictably continue to shape a franchising industry currently in transition.

We utilize proven economic, business, and behavioral models and theories to describe how brands grow from Early Stage, Emerging Growth, Regional, National, and eventually Iconic brand status. We also catalogue and demonstrate the common trips and traps where brands derail, creating a turnaround situation.

FPG introduces proprietary business models and strategies such as FPG Franchise Flywheel© (for sustainable brand momentum), FPG Brand Value Chain© (for creating a culture of value creation) and FPG Franchise Brand Growth Curve© (showing how brands must grow, adapt, and evolve over time and where and how franchisors fall off the curve).

We employ data sources such as FRANdata and FranConnect's Franchise Sales Index to show the current state of franchise opportunity supply and demand disequilibrium, predictably extending a franchisor's timeline to viability and increasing both the franchisor's risk and the investment necessary to achieve to royalty self-sufficiency and financial sustainability.

We catalogue the critical factors which catalyze and sustain brand momentum, creating a virtuous cycle of accelerated growth and value creation, even in the face of franchise opportunity supply and demand disequilibrium and franchise industry disruption.

We name "15 Attributes of an Iconic Brand" to provide brands a framework to compare what characteristics category-leading franchise brands – regardless of their industry – possess that competitors do not. Franchisors can use this framework to identify what is missing within their own systems and adapt accordingly to drive more growth and value.

Lastly, FPG seeks to create franchising's first end-to-end framework, which details a brand's complete journey from Start Up to Iconic National Brand and all stops in between.

About FPG

FPG is a full-stack franchising specialty consulting firm with over 100 years combined franchising experience working with over 120 brands.

FPG has perfected a franchising business platform that helps franchisors build growing, profitable, and sustainable brands. Our franchising framework is outlined within this body of work.

We also work closely with private equity firms, helping them buy right, build right, and exit at the highest possible enterprise value. Utilizing FPG's proven franchising platform, we help PE firms identify and mitigate risk.

Our franchising platform includes all of the following:

- Franchise candidate lead generation
- Content strategies that articulate the brand's value as a franchise opportunity
- Franchisee recruitment process design, ensuring franchisors build right by recruiting top franchisee talent
- Outsourced franchisee recruitment solutions
- Strategies to strengthen franchisee-franchisor relationships and corporate culture
- Brand strategy
- C-level and Board-level advisory services
- Financing solutions for startups, resales, franchisee expansions, remodels, and fleet leasing.

Visit Franchise Performance Group for more information.

My path into franchising

I graduated in May of 1985 with a BS in Marketing from the University of Connecticut. During my post-graduation job hunt, I read a story in the *New Haven Register* newspaper about a local sandwich chain whose home office was in the next town over from me. The CEO was quoted as saying eventually he was going to make his brand bigger than McDonald's. Over the previous 20 years, this local chain had cobbled together almost 400 restaurants in about 20 states.

I drove to the office and as providence would have it, they were hiring. I was immediately offered a job as a franchise salesperson.

That company was Subway.

While it took Subway 20 years to open 400 restaurants, it only took 3 additional years to open 2,600 more. In three years, Subway leapfrogged from a regional brand to the iconic international brand you know today.

After two months on the job speaking to candidates, it became abundantly clear franchise candidates didn't really want a franchise. They wanted outcomes. They wanted their lives, careers, and finances improved. Their current trajectory, whatever that was, was no longer a viable solution to get them where they wanted to go. They viewed their Subway franchise as a workable plan.

I asked myself, what better job could you have than to market people's dreams back to them as a very real possibility? At 22 years old and only a few months into the job, I knew franchising was all I would ever do. I had found my calling.

After working in franchisee recruitment and franchisor leadership roles for 17 years, I started FPG in 2002 to study, document, and systematize how iconic national franchise brands are built starting with Early Stage through National Brand status. FPG sought to offer and deliver to franchisors what franchisors offer franchisees, namely a proven, step-by-step business model franchisors can master in order to grow a profitable and sustainable national brand.

FPG now draws its experience from more than **100 years** of combined professional experience as franchisors, franchisees, and suppliers to franchisors, and from the combined experience we gained from working with more than **120 brands** ranging from Emerging Growth, Regional, National, Iconic, Turnaround and Resurgent franchisor brands in almost every business category. Our client list includes
A&W Restaurants, AAMCO, Alphagraphics, Arby's, BP, BrightStar Care, Budget Blinds, Burger King, Dunkin', Edible Arrangements, Expedia, Great Clips, Marco's Pizza, Midas, Remedy Intelligent Staffing, School of Rock, Snap-on Tools, Sport Clips, Subway, and UFC Gym.

FPG has studied brands that maximized their opportunity as well as brands that fell on hard times and failed to deliver, and what distinguished the two. We documented our findings into the executable strategies and visuals you will find here. We invite franchisor leadership, franchise candidates, private equity, and banking credit officers to use this work as a guide to pinpoint where a brand is in its growth cycle and anticipate the likely challenges it will face going forward.

A Brief History of Franchising: Three Eras of Thought Leadership

Franchising 1.0

Visionaries and pioneers like Ray Kroc (McDonald's), Fred DeLuca (Subway), and William Rosenberg (Dunkin' Donuts) created what FPG defines as Franchising 1.0 (1960-1990), a "better, faster, and cheaper" distribution model to get their products to market using other people's money (OPM) and effort. The franchisees assume the financial risk and the franchisor realizes almost risk-free recurring revenue streams.

The parent company often took the position that they owned the brand, product, and customer relationships. Franchisees were simple points of distribution, not stakeholders in the brand as it is thought of today. Fred DeLuca used to say, "I could own them or I could franchise them. I franchise them." As franchising thought leadership continued to evolve, the next generation of leaders believed this franchising paradigm was too simplistic.

Franchising 2.0

The era FPG defines as Franchising 2.0 began in the early 1990s and continues to this day. **The first generation of career franchising professionals emerged** and shifted the paradigm from franchising as a distribution model to franchising as a business unto itself. These franchising career professionals saw that franchising, regardless of the investment level or business category, seemed to operate under its own set of rules. Through the coordinated efforts of the International Franchise Association (IFA), event promoters, and media companies like Franchise Update and Franchise Times, career franchising professionals shared best practices. Leaders published books such as *Franchising for Dummies, The Educated Franchisee,* and FPG's *Street Smart Franchising*. They also produced some standardized franchising education like the Certified Franchise Executive (CFE) program.

They discovered that to build a viable franchise brand, franchisors must master two separate and distinct business models: the consumer-facing model and the business of franchising (as this generation of leaders currently defines it). **However, the current generation of leadership has not created the complete playbook for growing an Early Stage franchisor into an iconic National brand.**

Franchising 3.0: The Future of Franchising

FPG asserts Franchising 3.0 will be about maximizing franchising as a strategic advantage in the marketplace and accomplishing that by perfecting and documenting franchising as a business format. This body of work describes Franchising 3.0 as FPG now defines it.

Despite the size, reach, and revenues generated, the franchising ecosystem has not evolved with the level of intricacy, standardization, systemization, elegance, education, and sophistication one would expect from a high stakes, nearly trillion dollar industry. While individual brands within franchising have certainly elevated — category killers such as Domino's and McDonald’s — franchising itself hasn’t innovated, systematized, codified, or matured as other $100+ billion+ industries have.

According to *Franchise Business Economic Outlook: January 2018 Forecast* by IHS Economics, there are 759,000 franchised establishments in the U.S. representing nearly $757 billion in economic output.

To put this in perspective, franchising is more than twice the size of the nearly $300 billion automotive aftermarket industry (ASA 2017 estimates).

Let’s just highlight the auto industry for a second. The car was invented in 1885 by Karl Benz, a full 30 years after Albert Singer of Singer Sewing Machine fame was reported to have invented franchising. Look at how the auto industry has evolved since then.

The automobile industry is studied in universities (mechanical engineering, electrical engineering, and business). One can earn a Ph.D. in automotive engineering. In addition, there are technical schools and certification programs for both mechanical and auto body repair.

There are trade associations (Alliance of Automobile Manufacturers, National Automobile Dealers Association), government oversight (Federal Trade Commission, U.S. Department of Transportation, National Highway Traffic Safety Administration), consumer rating systems (Consumer Reports, JD Powers), case studies (Harvard Business Review, KPMG) and transparent and trusted sources for consumer information (Consumer Reports, NADA guides, Kelley Blue Book, CARFAX, TrueCar).

The automotive industry has created an entire ecosystem of auto-related providers that support, sustain, and innovate on behalf of customers and the industry itself. For instance, banks and company-sponsored financing programs make automobile ownership possible for almost all socioeconomic classes. Gas stations, auto repair businesses, auto body shops, tire shops, auto parts stores, and other service providers exist to extend the useful life of automobiles.

Comparatively, franchising as a brand strategy or entrepreneurial path (on the franchisee level) is largely ignored in business schools. In addition, there is little consumer advocacy, few franchising business analysts, and scant transparent third-party information about franchise brands that either a potential franchisee or a private equity firm looking to purchase a brand can trust to help them make more informed investment decisions and mitigate their risk. There are also few comprehensive rankings or scoring systems that franchise candidates, private equity firms, or lending institutions can count on to mitigate their risk. Franchising 2.0, relative to other similar-sized industries, remains the Wild West.

However, given its vast size (nearly 800,000 franchise units, 3,800+ brands, and $757 billion in output), inefficiency, opportunity, and unmitigated financial risk, franchising is now experiencing the kind of market disruption that forces self-examination and eventually leads markets towards innovation, reinvention, and transformation.

Over the years, FPG has worked to perfect an **end-to-end franchisor business model that** brands can follow to provide a road map from Early Stage and Emerging Growth to Regional Brand and eventually to Iconic National Brand status. FPG offers franchisors what skilled franchisors offer franchisees: a proven business format to profitably and sustainably grow a brand.

FPG has always shared its intellectual property, observations, and key learnings with all franchise brand stakeholders, private equity firms, and strategic vendor partners. Sharing best practices is a core FPG value.

In this body of work, we will detail FPG's franchise brand growth model on both an ideological and strategic level. We will leave it to individual brands to develop the skills and tactics necessary to execute these strategies and embed the ideology within their corporate cultures as they see fit. Of course, we are always available to help.

We invite the current and next generation of franchising leadership and stakeholders to advance this work, build on these concepts, and continue to share what works to the combined benefit of the franchisor, franchisees, strategic suppliers, and brand customers.

FPG seeks to help usher in the era of Franchising 3.0, which we believe is mastery of the franchisor business model as a proven, replicable, and profitable expansion strategy to build an Iconic National Brand.

Iconic Franchising Defined

FPG defines iconic brands as unique, well recognized, and profitable market-leading brands, offering their customers products and services with high perceived value and possessing a highly defensible position in the marketplace.

In classical business terms, iconic brands possess all of the following:

- **Strong brand identity.** Customers acknowledge and appreciate the brand's uniqueness, genius, or excellence.
- **Clear brand promise.** No matter what, the customer can seemingly always count on these brands to deliver a consistent product, service, or experience that exceeds customers' needs and expectations and solves customers' problems, creating customer satisfaction and loyal relationships.
- **High perceived value offering.** Customers consistently walk away with thinking, "That was a good use of my time, energy, and money."
- **Consistency.** Customers know what they are getting before they get it. The brands deliver value with a high degree of regularity and predictability.
- **Defensibility.** These brands have staked out a market position or niche that is uniquely theirs, creating high barriers to competitive entry.

Looking closely, these terms describe the brand's customer-facing model only. **Iconic brands must also become iconic franchisors** who successfully recruit, train, develop, resource, and lead peak-performing franchisees.

Best Practices – United States of America

FPG does not profess to have expert-level expertise in international franchising. We will leave it to the international reader to identify what works for their respective nations and leave the rest behind.

Definition of Terms

Before we get into what it takes to build a brand, let's first establish some terminology and definitions.

According to Dictionary.com, a franchise is "the right or license granted by a company to an individual or group to market its products or services in a specific territory."

FPG finds this definition insufficient.

From this point forward, we will be using the words **"franchise system**" to describe **the brand, its franchisees, supply chain, and franchisor's executives and employees.**

We will use the term **"franchise agreement"** when we refer to the actual license. We will use the term **"franchising industry"** to describe the $757 billion ecosystem of franchisors, franchisees, suppliers, and other stakeholders such as the IFA.

FPG defines **"franchising"** as **a brand expansion strategy entailing recruiting, training, developing, resourcing, and leading a team of successful entrepreneurs in order to build a profitable and sustainable brand.**

FPG defines the **"franchisee-franchisor relationship"** as **the contractual, commercial, and interpersonal relationships between the franchisor and franchisees.**

FPG defines **"franchisor"** as **the company that licenses a business system and trademarks to a franchisee** and the **"franchisee" as the licensee** of the same.

FPG describes **"the brand"** as **the meaning and value customers assign to a particular business.** In other words, it's everything customers perceive about a business: what the business represents, the service it offers, and the value customers receive by patronizing the business.

FRANCHISING FUNDAMENTALS

Every company that elects to use franchising as their go-to-market strategy ultimately engages in two separate and distinct businesses. The first business is its customer-facing model. The second business is franchising. Franchising is a business unto itself.

The business of franchising is ultimately supported by two broad brand pillars:

1. **Franchisees' profitability**. Franchisees must achieve their income and ROI objectives with a high degree of probability. The primary job of the franchisor is to create, refine, and perfect a business model that works.

2. **Trusting and workable franchisee-franchisor relationships**. The foundation of trust is built on franchisees' predictable and acceptable financial returns and transparency of information.

Franchisees' Profitability

FPG asserts a brand's current and projected franchisee-level profitability is the single greatest predictor of the brand's near-term and long-term success.

Franchisees' profitability expectations vary by franchise buyer profile, investment size, business type, where the brand exists in its growth cycle, and other mitigating factors we have yet to describe. We will offer financial targets later in this work.

The 80% Rule

Regardless of the brand or industry, FPG recognized a trend which shows that if approximately 20% or more of a brand's franchisees are not content with their financial returns or business trajectory, as well as the quality of the franchisee-franchisor relationship, the brand will most likely be heading into a turnaround situation within the next 1-3 years. This is true regardless of whatever success the brand has experienced in the past. **Conversely, once 80% or more of a brand's franchisees are happy and profitable, the franchise is positioned for growth.**

Franchisee-Franchisor Relationships

Regardless of whether both the franchisees and franchisor are meeting or exceeding their financial projections, if the franchisee-franchisor relationship becomes strained, they will each find that they invest more time and resources into trying to control or avoid being controlled by the other and less on collaborating to drive profitable growth.

Many breakdowns originate because of win-lose financial dealings between the franchisees and franchisor. Once trust is lost, it takes a long time to restore, often requiring outside intervention to recreate workable relationships.

Franchisees are entrepreneurs and, as such, are also rugged individualists. They are generally best led through influence and not top-down, command-and-control authority. Franchisees work best when they have the positive experience of being heard, resourced, and empowered. They resist being controlled and contained. They are generally big picture thinkers who can relate to the franchisor's CEO and ownership because they are also CEO's and owners.

As a brand grows, adds franchisees and builds more franchisor infrastructure, the relationships between franchisee and franchisor naturally evolve from informal to formal. But the basic underpinnings of trust should remain the same.

The franchisee-franchisor relationship begins with a commercial foundation, but with iconic brands the relationship becomes highly personal, with committed working relationships and a tight-knit brand community. Franchisees, franchisors, and key strategic vendor partners operate like a tribe, with the brand values at their core and profitable brand growth and protection as primary motivators.

The relationship melts down into a cold commercial relationship only when the informal and trusting relationships break down, core values are not being upheld, or contributions by brand stakeholders are not being honored or valued.

The relationship further disintegrates into a legal relationship when such things as the franchisor's professional boundaries and franchisees' investment dollars aren't being respected.

Successful franchisors honor and nurture these bonds of trust by providing franchisees consistent transparency and open lines of communication.

Franchisees and franchisors depend on each other executing their jobs well to ensure mutual survival and strong returns on everyone's time, money, and energy.

The Unwritten Franchisee-Franchisor Social Contract

Ultimately, **the franchisee's job** is to serve their customers to the best of their ability in a way that's consistent with the values, standards, and original intent of the franchisor and **to add more perceived value to the customer than the customer pays in price.**

The franchisor's job is to maintain the integrity of the brand and create processes, systems, structures, products, marketing, and other resources which drive profitable revenue growth, and **to add more perceived value and tangible financial results to franchisees than franchisees contribute to the franchisor in royalty dollars**.

As long as each is honoring their commitment to the other, the brand will elevate. When one party believes the other is not delivering its fair share of value, parties frequently invest more energy into assigning blame than competing for market share.

When franchisee-franchisor relationships break down, parties tend to make their disputes personal and often antagonistic. Typical rules of civil business discourse go out the window.

Franchise systems with consistently strained franchisee-franchisor relationships should consider third-party interventions to help restore trust and workability.

How franchisors think determines how brands act

How the franchisor leadership values franchisees ultimately translates into policies, systems, and procedures that will be designed to either unlock the franchisees' (and therefore the brand's) full potential or attempt to contain and control franchisees.

A franchisor's leadership tends to think of franchisees one of two ways:

1. Franchisees are a strategic asset leading to better execution and a competitive advantage in the marketplace.
2. Franchisees are a brand liability, posing a potential downside risk that needs to be capped.

The outlook that is chosen dictates corporate culture. If the franchisor sees franchisees as a liability, they will often respond by creating a highly legalistic, compliance-driven, and top-down command-and-control structure that diminishes and devalues the contributions of skilled and experienced franchisees, creating unnecessary stress. Franchisee stress and dissatisfaction often lead to a decrease in the quality and consistency of their execution, negatively impacting the customers' brand experience.

A franchisor's self-sabotaging beliefs over time will create a snowball effect that stops forward momentum and ultimately necessitates a turnaround.

Leaders with franchisee philosophy No. 1 possess the highest probability of building an effective high-performance franchisee community, becoming a market leader, and creating a valuable and iconic national brand.

Conversely, leaders with philosophy No. 2 often breed distrust, leaving the brand exposed and vulnerable to an iconic or soon-to-be-iconic franchise brand operating from philosophy No. 1.

5 Common Characteristics of Winning Franchisors

FPG asserts each franchisor is in two separate and distinct businesses: the customer-facing model and the business of franchising. To capitalize on market potential and create long-term value for all brand constituents, the brand needs consistent mastery-level execution of both businesses. First, we will address what iconic franchise business models have in common, and then we will address what consumer-facing market leaders have in common.

Winning franchisors craft a franchise offering marked by the following attributes:

- **Unique products and services**. The business model has to offer customers something different, better, and more valuable than comparable businesses. If not, the market will quickly become inundated with copycat concepts, commoditizing and devaluing the products and services, killing opportunity for franchisees, and perhaps forcing them to compete with no real competitive advantage. Dan Cathy, CEO of Chick-fil-A, is reportedly fond of saying, “Every business has to have its chicken sandwich.” However, people don’t go to Chick-fil-A just for the chicken sandwich. They offer a unique customer service experience called “polite” which no other company seems to be able to pull off at a Chick-fil-A level. Their hiring and training methods for rank-and-file workers is best-in-class. Christian-owned, they are public with their beliefs about treating customers and employees with courtesy and respect, and the market continues to reward their values on unprecedented levels.

  Do not confuse unique with “first-to-market.” Unique strictly means “difficult to copy.” Several years ago, self-serve yogurt became the frozen dessert customer experience of choice. Brands copied each other’s colors and store designs, bought yogurt from the same dairies, and ultimately created a mass commoditization of the segment. Thousands of frozen yogurt shops opened all over the country over a short period, flooding the market. Just like any commodities market where supply exceeds demand, the yogurt chains got into a price war, killing margins. These businesses started cutting staff, meaning they didn’t have enough people on payroll to keep the toppings bars and bathrooms clean, creating a negative customer experience, eventually killing the category.

- **Profitability**. The model must consistently exceed the expectations of the franchise candidates most likely to invest in it. The CEO of an emerging growth brand once told FPG, “Our franchisees don’t think they are making money simply because their checking account balances are declining. They don’t look at the key performance criteria of the business. They are doing great!” That’s what “I don’t get it” sounds like. **The franchisees’ definition of success is all that matters.** How franchisees define acceptable financial returns will vary by brand, franchise buyer profile, and category. We provide predictable guidelines in Chapter 4.

- **Defensibility**. The franchisor’s consumer-facing model must present high barriers to potential competitors by being difficult or too expensive to copy. Otherwise, the market will rapidly attract new entrants, oversaturating and commoditizing the franchisees’ product or service offering, driving down the price and eroding margins, and devaluing the brand. Some franchisors confuse such things as “first to market,” “largest brand,” or "fastest growing" with a defensible brand position. "Defensibility" answers the question, "How well will this brand hold up to competition?"

For example, in the past, category-leading remedial education chains were profitable because the high hourly teacher's labor expense was spread out over the 3 or 4 students each teacher tutored at one time. However, in-home tutoring chains emerged offering one-on-one tutoring. As in-home and one-on-one tutoring became an expectation for many customers, it created a threat for larger, brick-and-mortar remedial education chains. These chains were stuck with the high fixed costs of an office or retail location, while competitors using the in-home model benefitted by low overhead. To keep up with customer demand, brick-and-mortar remedial education chains offered more one-on-one tutoring, eroding their profit margins.

The next wave of tutoring will most likely be delivered virtually, which will eliminate commuting and reduce expenses further. There may emerge lower-cost providers who pass some of these labor savings to customers, thus creating a pricing advantage and putting even more of a squeeze on the higher fixed-cost remedial education models. The more established brands have difficult positions to defend.

- **Value to customers.** The brand has a clear understanding of how their target customers define value, and the underlying business model consistently delivers value that exceeds the price points customers pay. *FPG details 14 different consumer value propositions later in this work.*

- **Value to franchisees.** Franchisors create value for franchisees by perfecting a business platform which adds more perceived benefit to franchisees than it extracts in royalty dollars and other costs. The franchisor's business platform includes such things as marketing, training, processes, systems, strategic relationships, and support which work in unison to create a flywheel effect. This virtuous flywheel helps franchisees deliver the customer value proposition by perpetuating a consistent brand strategy and brand identity. When franchisees are asked, "Knowing what you know now, would you make the same decision again?" a full 80% or more of the franchisees polled should answer, "Yes." If not, the franchisor almost certainly suffers from a franchisee-franchisor relationship problem, a unit-level economics problem, or both.

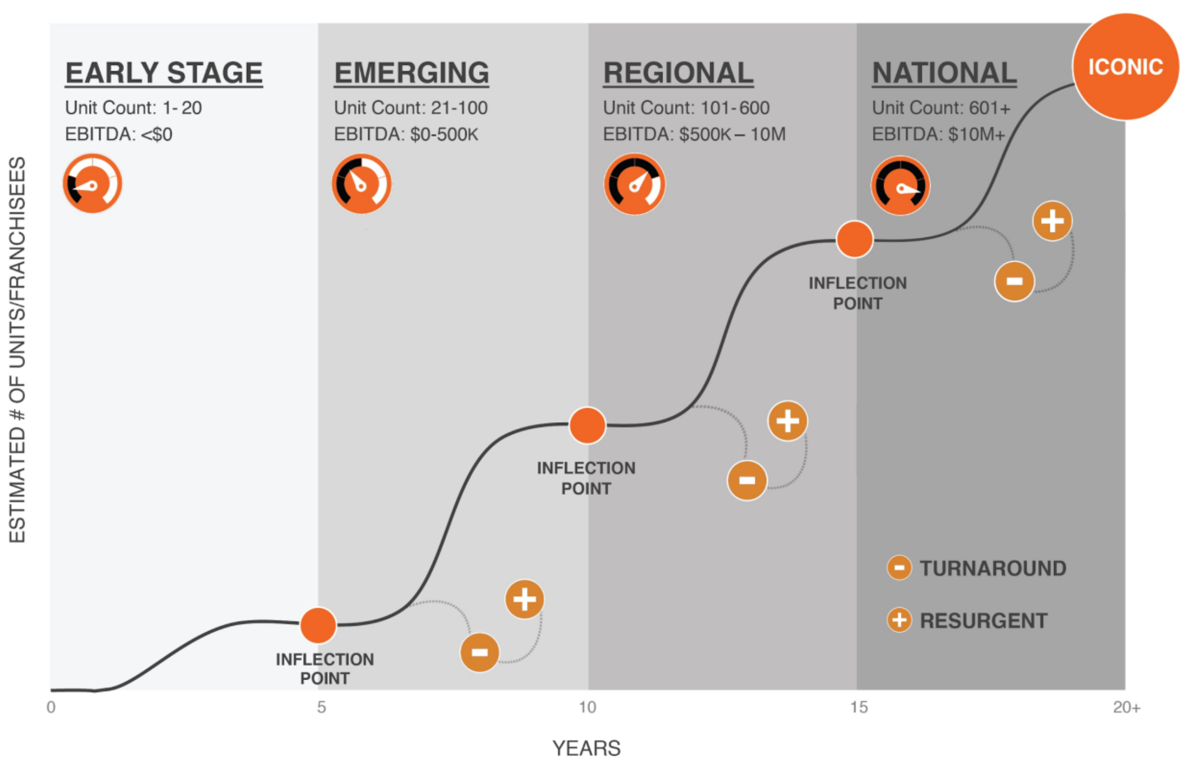
- **Sustainability**. The brand position has proven it is defensible against competitive threats such as disruptive technologies or similar business models. Additionally, the brand's product and service offering must continue to stay relevant well into the foreseeable future.

  For instance, one iconic franchisor used to make their money exclusively by marketing replacement automobile exhaust systems. At one time, due to rust and corrosion, auto exhaust systems often needed to be replaced every 5 years or so. When automobile manufacturers started making exhaust systems from stainless steel or aluminum, exhaust systems gained greater durability, threatening and disrupting their core businesses. They were eventually forced to pivot into becoming a general maintenance and repair business, going after lines of business the brand was historically not known for, such as replacing brakes and rotors.

Fitness and weight loss brands often start up trying to capitalize on the latest fitness trends, seemingly worrying more about making quick money rather than creating a sustainable brand. Many brands also make the mistake of tying the brand to a particular product category that has become trendy — such as cupcakes, home-meal replacement assembly kitchens, and "sell-it-on-eBay" stores. By doing so, they inadvertently attach the brand to the product's life cycle. This means if the product demand declines, the brand becomes irrelevant, creating the strong possibility of a premature brand demise unless the brand successfully pivots as depicted in the graph.

Any business that doesn't consistently exhibit these 5 characteristics and doesn't rigorously measure, resource, reinforce, and defend them will develop fatal flaws that will lead to a weakened competitive brand position. This, in turn, will lead to an almost certain growth plateau. Left unaddressed, the brand eventually plunges headlong into a turnaround scenario as depicted in the following graph.

FPG Franchise Brand Growth Curve®



FPG has found that for each year a brand spends in decline or turnaround, it takes two to three years to dig out — and only if concerted effort is applied by the franchisor's leadership.

We will discuss this graph in greater detail later in this work.

Customer Value Propositions

Successful franchisors drive value for franchisees and customers by crafting product and service offerings that provide greater perceived value to customers than they spend in money.

FPG has identified 14 distinct ways customers perceive value. Iconic brands have historically staked out positions in one or more of these areas in order to dominate their competition in the marketplace.

Those attributes are:

1. **Innovation**. Customers acknowledge these brands sell the most advanced products and services.

   For instance, one franchisor built a strong national brand through a proprietary technology that allowed franchisees to pinpoint and fix hard-to-find leaks in pools and spas in a noninvasive way, rescuing homeowners from the expense and frustration of having to rip up large swaths of their yards to resolve the issue. Chem-Dry carpet cleaners have a patented product to use carbonated water to lift stains from carpets much in the same way club soda lifts wine stains from a blouse. Most companies relying on innovation rely on constant research and development and reinvestment. Most entrepreneurs looking to start franchises resist getting into businesses that require constant reinvestment due to quick product or service obsolescence. Franchisors who rely on innovation as their key point of difference don't seem to survive unless the franchise system holds a patent or has exclusive distribution rights for a patented product. Franchising appears to move slower than technology. For example, most franchisors don't penetrate 100 new markets within 10 years, yet 10 years in a technology business is an eternity. By the time an innovative company can achieve any significant level of market penetration through franchising, chances are their initial advantage will already be obsolete.

2. **Necessary to the customer**. Customers simply cannot do without these products and services. Luxottica built a multi-billion-dollar business by manufacturing and distributing eyeglasses and contact lenses through such retail brands as LensCrafters and Pearle

Vision. Beltone did the same with hearing aids.

3. **Price leaders.** These are brands that sell products cheaper than everyone else. Examples include Walmart, McDonald's, Taco Bell, Domino's, and Subway. Price leadership can be a real competitive advantage or a slippery slope. Well-managed brands demonstrate high degrees of operational excellence along with a competitive advantage on supply chain. However, this strategy may also add risk, which threatens long-term sustainability since costs are usually going to increase, and brands may have already trained their customers to resist paying more. Sometimes brands inadvertently educate the market to expect a specific price point, such as Subway's promotion of $5 footlong subs. When rising labor and protein costs made it unprofitable for Subway franchisees to continue with their $5 sub offering, many customers pushed back hard and rejected the higher price point or reduced their frequency of visits, leading to sales and profitability declines for many franchisees.

4. **Customer experience or service leaders**. These concepts include a unique customer experience or higher service expectation in their product offering and often charge a slight premium for the value-added experience. Examples include Starbucks, Dick's Last Resort, and Rainforest Cafe. Youth sports brand i9 Sports has designed social sports leagues that place a high value on a parents' experience as well as the children's. Re-Bath sets itself apart as a remodeler by carefully managing their customers' experience from design through installation and post-installation so they can get in and out of a customer's home in 5 days or less. These brands often invest big dollars in training tools and staff development programs. However, if the customer doesn't value the experience, they won't pay the premium, sales will decline, margins will get squeezed, and the brand will struggle. If customers value the experience and brands demonstrate a strong ability to replicate this experience across their network, other brands will have difficulty copying their value proposition and creating a competitive advantage.

5. **High perceived risk for change**. These brands have an opportunity to lock up their customer base as long as they meet their customers' minimum satisfaction threshold. Examples of these business include maid service brands. These brands regularly enter people's homes and therefore must earn the customer's trust by doing four things: 1. Come on time. 2. Clean the house well. 3. Leave on time. 4. Refrain from stealing. As long as the brand meets these expectations, they will create a repeat customer with a high lifetime value. This is the same for janitorial brands who work commercial accounts. Dirty bathrooms disrupt business and kill employee morale. A janitorial service that consistently keeps restrooms tidy can expect to keep clients for years.

6. **Customer intimacy.** These brands build deep and committed personal relationships with their clientele. Examples include senior care businesses such as Visiting Angels, Home Instead, Comfort Keepers, BrightStar Care, and ComForCare. Others form a community or tribe, like CrossFit and Orangetheory Fitness. Once these relationships have formed, customers find them difficult to recreate, and therefore they perceive a

high risk for change.

7. **Speed and convenience.** These brands focus on getting customers in and out fast, minimizing life disruptions and playing off the high value their time-starved customers place on convenience. These brands may charge customers a premium and attract customers who place a high value on time. Great Clips is a great example. These brands are often mobile, such as 1-800-DryClean, which picks up and delivers dry cleaning services for a premium. Little Caesars' Hot-N-Ready Pizza strategy capitalizes on busy customers who don't have time for a home-cooked meal. If the business is brick-and-mortar, companies need to be very skilled in real estate selection, as time-crunched customers look to stay in a small shopping orbit and do it all in one trip.

8. **Lifestyle.** Harley Davidson doesn't really sell motorcycles. They sell freedom on the open road." Lifestyle brands often have high ego appeal. Lifestyle brands can also promote shared values with their customers, such as faith-based Christian Brothers Automotive.

9. **Aspirational/luxury.** These businesses sell premium services and luxury brands, such as Expedia CruiseShipCenters, which specializes in selling luxury cruise vacations.

10. **Disruptive**. These brands reinvent products and services, altering what customers value and how they shop. Planet Fitness disrupted the highly commoditized gym model through a high-value/low-cost offering. Jiffy Lube disrupted car maintenance service by inventing a method for oil change and basic car care in 30-minutes or less. Disruptors often give their franchisees a 2- to 3-year head start on the competition before copycat concepts roll out. They need to grab the "first mover" position, or they will lose to a copycat concept that accelerates past them.

11. **Socially responsible.** These brands have a reputation for being solid corporate citizens who give back to the community or the planet. TOMS Shoes is a classic example. While many franchisees give back to their local community, these brands build charity into their brand identity and tie it to their product or service offering.

12. **High value/affordable luxury.** These are premium brands with products or services still within reach of middle-income America. For instance, Massage Envy's monthly subscription model made spa services more affordable for their customers. Kilwin's offers customers high quality yet still affordable ice cream and confections.

13. **Expertise/thought leadership.** These brands are highly focused and have deep domain knowledge within their industry. For instance, Fleet Foot is a specialty retail store for runners. EarthWise Pet provides its customers with expert knowledge and unique products to maximize pet health. GNC specializes in personal nutrition and wellness.

14. **Customization and personalization.** These brands offer customers a unique and precise combination of what they want, how they want it, and when they want it. This business model is often explained as mass customization, meaning they have developed a scalable model that allows customers to cost effectively tailor their product or services to unique specifications. Pizza places, self-serve frozen yogurt chains and Chipotle/Subway-style assembly line restaurants are all examples of this.

    If poorly executed, this strategy can also backfire. For example, Cold Stone Creamery wowed customers with their system for mass customization of their ice cream, but customization also meant slower service times. As the brand grew popular and lines got longer, the increased wait times created a negative customer experience, resulting in declining sales.

This list may not be exhaustive. However, it is FPG's experience that any brand that fails to build a reputation for consistently delivering the benefits as defined by one or more of these attributes will quickly see its services commoditize, causing results to plateau and eventually decline.

Again — for each year a franchise brand is in decline, FPG's experience shows it takes three years to right size.

Regardless of the business category, most franchisors can't afford to lose 3 years or more in a turnaround situation.

FRANCHISE INDUSTRY OVERVIEW

Marketplace Disruption

Franchising is looking at a possible significant near-term market correction.

This predicted market disruption, caused by multiple limiting factors working in synergy, leads me to believe market dynamics will only become more pronounced over the next few years. In no particular order, these factors are:

1. **Oversaturation of franchisors.** In 2017, research firm FRANdata reported there were about 3,800 franchise brands in the United States, at or near a record high for franchising.

2. **Fewer new franchise candidates entering the market**. Consulting firm Franchise Performance Group (FPG) and FRANdata both estimate that in any given year, only 13,000-20,000 franchise candidates invest in new franchises.

3. **Hundreds of new concepts enter the market each year.** In any given year, 250 to 350 new concepts choose to franchise, adding more noise to an already crowded marketplace. Most new concepts do not add new buyers — instead, they further dilute ratio of buyers to concepts and further disrupt the demand/supply curve.

4. **Decreasing new business starts**. 2015 figures from the U.S. Census Bureau (the latest data available at this time) reported 414,000 new business starts that year, down 8% from 450,000 new business starts in 2014. That was the lowest total in 40 years. Since this report, unemployment has declined more than 20%, leading FPG to believe business starts will continue to decline before leveling off.

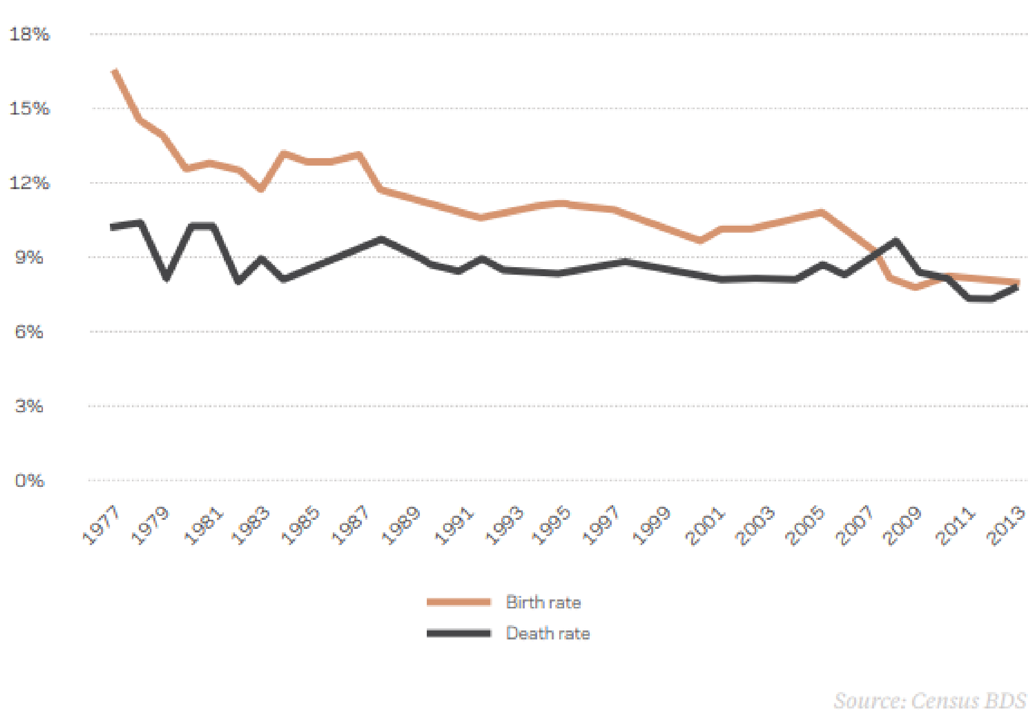
5. **Lower unemployment leading to lower risk tolerance**. When the U.S. Census reported their data in 2015, unemployment was over 5%. The Bureau of Labor Statistics reported May 2018 unemployment at 3.8%, the lowest in 18 years, and 3% or less for people age 35-54, which is the group most likely to invest in a franchise. When unemployment is high, starting a business looks more secure than the job market. When unemployment is low, the job market looks more secure than starting a business. TTI Success Insights estimates 40% of the U.S. population is primarily motivated by safety, stability, and security rather than other drivers such as independence and control.

6. **The surging stock market outperforms franchise business returns.** From January 2016 to May 2019 the Dow Jones Industrial Average increased over 50%. When the stock market surges, franchise candidates have higher opportunity cost with lower perceived risk. Many resist pulling out funds to start a business because of their high perceived opportunity to earn returns through the stock market. High consumer

confidence and robust job growth numbers will lead many investors to believe in continued record stock market highs, creating more resistance to reallocate these funds into ventures that may have a perceived higher risk. Some, however, will take their gains and, borrowing a Vegas expression, feel like they are playing with the house money and take on more risk. These generally are not the most sophisticated of franchise investors.

7. **More business closures than new business starts**. For other historic firsts, in its February 2017 white paper *Dynamism in Retreat*, Economic Innovation Group reported that since 2008, the number of business closures more or less equaled or exceeded startups, with the current trends moving toward across-the-board consolidation.

3. Firm birth (startup) and death rates



Their research concluded these trends were pervasive across industries and geographies, aligning microeconomic and macroeconomic trends. Their bottom line is we have entered into a previously uncharted market where people are more risk-averse and less entrepreneurial than any other time in recent history.

8. **Increasing costs of business.** With low unemployment comes wage increases. Higher wages lead to higher product and service costs, squeezing margins particularly for companies who are low-cost providers or who operate in commoditized markets. They may find it difficult to pass their cost increases along to their customer base.

9. **Increasing cost of money.** Since December of 2016, the prime rate has increased by 1.75 points, leading to a higher cost of money. Again, companies may have a difficult time passing interest rate cost increases to the customer, thus eroding margins.

10. **Decreasing margins.** Franchisors currently operating at below 15% EBITDA may see their EBITDA percentage dip another 1-2 points, perhaps adding more perceived risk than their current crop of franchise candidates are willing to assume, stunting growth.

It is unwise for brands to ignore these trends, thinking somehow the brand will remain unaffected by the broader economy. Given what FPG believes to be great disequilibrium in the franchise candidate demand/franchisor supply curve, we expect to see consolidation among franchisors.

In the short term, these inhibiting factors will make it harder, but certainly not impossible to grow sizeable and significant brands. Regardless of the economy, smart, well capitalized, disciplined and high value franchisors with profitable business models continue to grow at a favorable clip. The lower value, undifferentiated, lower skilled copycat franchisors offering franchisees unpredictable returns need to be concerned and correct their course.

Strong Brands Will Become Stronger

The strong economy will lead to stronger unit-level economics for many brands — and because the economy is growing at the same time, there are more business closures than business starts, dominant and skilled brands can expect a disproportionate share of this increase, bolstering their leadership position and driving cash flow.

Both consumer confidence and GDP are trending up as depicted on the following graphs:

The is fertile ground for franchisees to grow their businesses, resulting in potentially higher franchisor royalty collections for the most competitive brands.

FPG expects to see strong year-over-year sales increases for existing franchisees of already dominant Regional and National brands and well-positioned Emerging Growth brands. Sales gains should improve the franchisors' average unit-level economics and help franchisors tell a better story to their target franchise candidates.

Market Disruption: Opportunities and Risk Factors

Franchise candidates don't invest in franchising — they invest in individual brands. This means well-run and well-executed brands with profitable business models can and will buck larger microeconomic and macroeconomic trends. They aren't necessarily tethered to franchising as a whole, **unless they make the fatal mistake of thinking and acting like other franchisors.**

FPG predicts the current market conditions will also lead to franchisor consolidation and shakeout. It's imperative franchisors start thinking and acting differently to avoid being a casualty. Any business that executes the basics well during tough economic times will capture a disproportionate share of the market as the market corrects and rebounds.

Smart and well-capitalized brands will need to invest the time, money, and energy to look, act, and operate like large national brands while still in the Early Stage and Emerging Growth stage of development.

The time when an unrefined franchisor could develop their model through trial-and-error using franchisees' investment dollars is over. Franchisors who don't have the $1M-2M of financial backing to reinvest back into their brand to perfect the model prior to pushing hard to recruit new franchisees will most likely suffer during this disruption. These brands will either collapse, stagnate, or get picked up by value-shopping private equity turnaround specialists or market consolidators. Franchisors should expect new franchise candidates to put as much emphasis on the franchisors' P&Ls as they put in the franchisees' P&Ls while making an investment decision as to which brands they will invest in.

40 Years to Break-Even?

In 2016 and 2017, FRANdata reported franchise brands opened 27,000 and 28,000 new units respectively. Let's assume 50% of this new unit growth came from existing franchisees expanding. FPG has not been able to source the real numbers, but our experience shows that with most mature brands, 50% or more of their growth comes from existing franchisee expansions.

Therefore, FPG and FRANdata both estimate that over the last few years, only 13,000-14,000 franchise candidates invested in a franchise across all brands.

In their 2018 Franchise Sales Index, FranConnect reported that out of the nearly 500 franchisors they researched, about 80% of the new deal flow went to brands with over 75 operating units or territories, which FPG would classify as either late-stage Emerging Growth Brands, Regional Brands, or National Brands. According to generally accepted statistical analysis, this sample size statistically creates a 95% confidence level with less than 5% expected margin of error for the following chart.

Follow the math.

Category	Data (or Estimate)	Source
Estimated number of franchise brands	3,800	2017 FRANdata study
Estimated number of Early Stage and Emerging Growth brands	3,100+	2017 FRANdata study
Estimated number of new franchisees joining any system	14,000	FRANdata and FPG estimates
Number of new franchisees joining Early Stage and Emerging Growth	2,800	FPG estimates based on 2018 FranConnect Franchise Sales Index findings
Estimated number of new franchisees entering franchising each year	300-350	FRANdata
Estimated number of operating units needed to achieve royalty self-sufficiency	40-100	FPG franchisor financial models
Average number of new franchisees per Early Stage (including Startup) and Emerging Growth franchisors	LESS THAN 1	Simple Math. 2,800 estimated new franchisees divided by 3,100 estimated Early Stage and Emerging Growth franchisors.
Estimated time for Early Stage and Emerging Growth Franchisors to achieve royalty self-sufficiency.	40 to 100 years Putting it another way... **NEVER**	FPG models based on best available evidence.

Franchising research firm Franchise Grade studied 10 years of startup franchise growth beginning in 2007. They found that over a 4-year period, more than 30% of startup franchisors had 0 to 1 franchise locations. Ten years from launch, more than 50% of this group had 50 or less franchise locations, meaning many had not achieved royalty self-sufficiency and thus had to continue to sell franchises to make franchisor payroll.

This means that thousands of business concepts have at one time hired consultants and attorneys who communicated that if these brands would only invest $150,000-$250,000 or more into their consulting companies or legal firms, they would turn these brands into viable franchisors. **They were wrong 50% of the time. That's the same odds as a coin flip, but coin flips don't cost brands $250,000.**

Also, keep in mind that Emerging Growth, Regional, and National franchisors who have been franchising for more than 10 years did so with far less competition and disruption than the newest generation of franchisors.

Why Candidates Often Avoid Smaller Brands

Why is the available franchise candidate market rewarding larger brands rather than Early Stage and smaller Emerging Growth brands? It's not necessarily because of the size of the brand. FPG believes it depends on the size of the opportunity compared to the perceived risk. Smaller brands historically have proven to be less refined, less sophisticated, and produce less returns than larger brands. If smaller brands can't demonstrate consistency of returns, they present higher risk. As a result, candidates' interest and investment goes to the chains with best-in-class economics with the lowest historical and perceived risk.

Many times, when FPG discusses opportunity, small franchisors come back with, "We have large territories available, therefore we have tremendous opportunity." The franchise investor doesn't define opportunity according to green grass and blue skies. He defines opportunity according to the predictability and desirability of the franchisor's historical unit-level economics.

Here is the bottom line. **Franchise candidates will always invest in unique, proven, profitable, replicable, predictable, and sustainable models. This is what people have always sought by purchasing a franchise license.** In the new era of franchising, franchise candidates will be more educated and discerning, possessing a greater understanding of what a sustainable brand looks like in all stages of the franchisor's growth curve. They will not be as easy to fool and convince as past franchise candidates.

Stronger opportunities will cut through the noise of the existing crowded marketplace and tell their story to franchise candidates who want what they are offering and match the profile of a successful franchisee.

The best predictor of whether a franchisor may become an iconic national brand is that they already look, feel, act, support, perform, and deliver customer value like an iconic brand while still in the Emerging Growth stage.

ASSESSING THE HEALTH OF A FRANCHISOR

FPG gets many calls about assisting franchisors with turning around franchise development departments. They look at metrics such as lead-to-close ratios, cost-per-deal, speed-to-lead, and other sales KPIs, reducing problems to oversimplified franchisee recruitment metrics.

When we peel back the layers and look at the core business, we find things like this: The model doesn’t work in higher occupancy or labor cost geographies; the franchisee-franchisor relationship is strained; the management team is weak; strategy is out the window and the leadership team is engaged in daily firefighting; the competitive set has changed, which in turn hurts profitability of some franchisees; and startup costs are rising, lengthening break-even and creating systemic undercapitalization of franchisees.

When we point out these issues to leadership, they often myopically say, “We had no problem selling it last year. We just need more qualified leads.”

Franchisor Health Indicators

Due to higher perceived investor risk and inconsistent financial returns, it is difficult to attract franchisees to a struggling brand. Growth requires total brand health, which hinges primarily on 6 factors:

1. Franchisor capitalization
2. Unit-level economics
3. Scalability
4. Competitive advantage
5. Skills, experience, and aptitudes of the franchisee and franchisor talent pool
6. The quality of the franchisee-franchisor relationship

Given the oversupply of franchisors, how many franchise candidates would knowingly invest in a franchise with the following characteristics:

- Inexperienced leadership team
- An undeveloped and unrefined business model versus their competition
- High startup and operating costs that diminish margins and profitability
- Increased competition impacting revenues and profitability
- No workable strategy to turn the franchise system around

Franchisee recruitment results will automatically decrease as a direct byproduct of these larger system breakdowns. In these instances, franchisee recruitment results slowly come back only after the brand has successfully executed a turnaround. **In a turnaround situation, franchisee recruitment results are the first to go and the last to come back.**

Franchisor Capitalization

FPG has polled close to 100 founders of mature brands about how much they needed to invest in their organization to grow it past the point of royalty self-sufficiency, and often the amount ranged from $1M to $2M, but never under $1M. Additionally, every founder uniformly stated their franchise fee revenues were never sufficient to capitalize the company. Almost always, franchise fee revenue covered the cost of advertising the opportunity and the overhead of the franchise development department, but it could not cover the cost of infrastructure, brand refinements, or other investments needed. Those sources of capital had to come from elsewhere.

In other words, the franchise development department did not contribute to cash flow; it broke even.

New franchisors are often told, “You can grow your business by investing $150K-$250K and then using OPM...other people’s money.” FPG finds this to be a fallacy and false “franchisor folklore.” Yes, someone can START a franchisor for as little as $150K. However, a company cannot grow a successful, profitable, and sustainable brand for $150K. If the brand isn’t starting with an accessible war chest of $1M, the brand is undercapitalized.

FPG believes the most important financial milestone a franchise first needs to reach is royalty self-sufficiency.” This is the point at which the franchisor’s recurring revenue streams surpass the costs of running the franchisor’s organization. Put another way, the franchisor does not need to award another franchise to survive. Once franchisors achieve royalty self-sufficiency, leadership often becomes more selective as to which franchise candidates are awarded a franchise.

Paradoxically, in 2017 FRANdata estimated 83% of franchise brands had less than 100 operating territories or units. **Depending on the complexity of franchisees’ support needs and the gross <u>per unit</u> recurring revenue stream a franchisor realizes, FPG’s franchisor financial models show most franchisors achieve royalty self-sufficiency between 40 and 100 operating territories and units.**

This means potentially 4 out of every 5 existing franchisors is at serious risk.

Unit-Level Economics

The franchise business model must consistently exceed the expectations of the franchise candidates most likely to invest in it. Models with strong financial returns create a strong “pull demand” for their franchise, meaning their brand’s reputation as a lucrative investment opportunity goes viral, prompting qualified candidates to take action and seek to learn more. Here are some basic and common financial benchmarks franchisors should already be achieving to create demand for their franchise:

- Franchisees should be able to retrieve their total investment in 3 years or less.
- For investor models, the market rewards 20% or better ROI and 50% or better cash-on-cash return, with a minimum return of $75,000 per unit, after paying a manager and before debt service. Investors should ramp to this level within 24 months.
- For owner-managed businesses, the target owner should be able to replace their current income in year 2 and achieve 25%-35% or more replacement earnings growth in year 3.

- For more scalable owner-manager models, the owner should be able to pay themselves an income consistent with market value if they were an employee, plus offer ownership 25% ROI after their owner's draw in year 3.
- For restaurant and retail models, franchisees should experience 15% EBITDA on sales.
- For service models, EBITDA should be 20% on service models.
- The model should exhibit a 2-to-1 or better sales to investment ratio, meaning if the investment is $500K, sales need to quickly clear $1M.

These are estimated financial targets. Franchisors should continually poll existing franchisees as to whether their financial objectives are being met. They should be collecting quarterly P&Ls and measuring key financial performance criteria. They should be holding regular profitability coaching calls with franchisees. From these efforts, the franchisor will establish a clearer picture of what their brand needs to consistently produce to satisfy new and existing franchisees.

Scalability

Unit-level economics play a major role in scalability. Successful and masterful franchisees should be able to profitably expand into new markets and ramp up quickly, achieving profitability within 6-12 months. With some mobile concepts or hub-and-spoke models, franchisees often take a step back in profitability as they take on more trucks, routes, or brick-and-mortar locations, making less money short-term to increase their opportunity. If the business ramps slowly, existing franchisees may elect not to take on the additional risk, and sales will plateau as their existing business matures. This forces franchisors to expand only by recruiting new franchisees, forgoing highly profitable and low-risk growth from their competent pool of existing franchisees.

Franchisors often don't think about how much less time, money, and expense it takes to service existing franchisees than it does new franchisees. Existing franchisees typically need far less support from a franchisor's teams, which means profit margins on royalty streams from existing franchisees will be higher. More often than not, franchisors support the franchisee — not the unit, territory, or location. This means a three-unit franchisee is not three times more expensive to support than a single-unit franchise. They are marginally, if at all, more expensive to support than a single-unit franchisee; however, they contribute three times the royalty revenue at lower brand risk.

Another critical factor for scalability is the overall demand for the product or service offered. Catering to regional needs or tastes can be dangerous for a franchisor, since it can limit sales and growth opportunities to a narrow range of territories. Products and services like hurricane shutters (which require hurricanes), snow removal (you need snow) can limit territory. Other services, like gutter cleaning, may be time-sensitive (you need falling leaves). These may not generate the kind of recurring revenue franchisors need so they can reinvest back into meaningful tools and support to give franchisees competitive advantages.

Competitive Advantage

Given that the best available franchising data suggests an oversupply of franchisors, franchisors need to provide franchise candidates something more, better, and different than what the franchisor marketplace already has in abundance. For instance, Christian Brothers Automotive offers its owners a guaranteed draw, reducing risk and providing comfort during the transition from employment to self-employment.

Skills, Experience, and Aptitudes of Franchisors and Franchisees

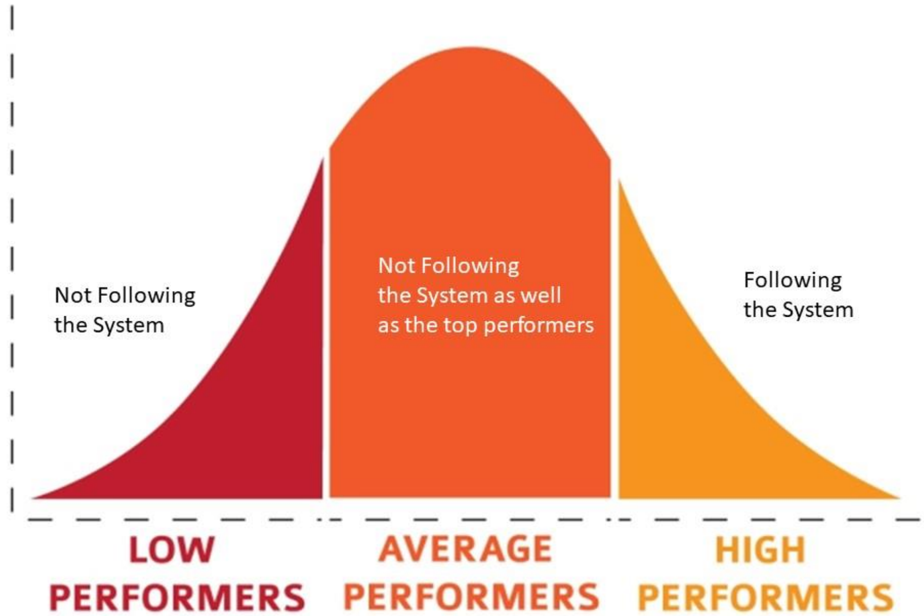
Franchising seems to prop up professional clingers, low-skilled career professionals who jump from brand to brand and somehow string together 15- or 20-year careers without really accomplishing much or acquiring the skills to perform their job at an expert level. Franchisors often seem to confuse “years of experience” with “skills and results.” Franchising is a highly nuanced business, therefore a franchisor should already have skilled executives who have successfully grown and guided at least one other franchise brand through the growth stage (Early Stage, Emerging, Regional, National, Turnaround, Resurgent) where the brand currently resides.

Average and below average franchisor leaders tend to view their franchisees’ financial performance through the lens of a false assumption: “My system is always right.”

Then they mentally chunk franchisees into three broad buckets:

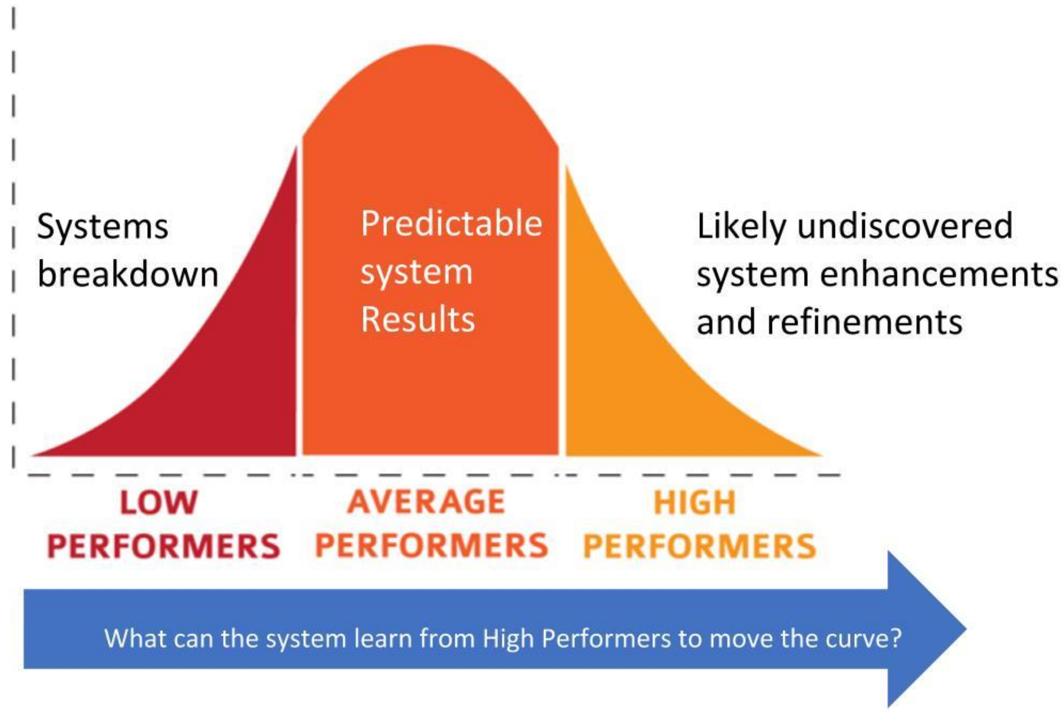
- Franchisees who follow the system
- Franchisees who don’t do as well as the franchisees who follow the system
- Franchisees who don’t follow the system

Here’s how they perceive the franchisees’ performance bell curve:



Peter Senge, Sloan School of Management lecturer, founder of the *Society for Organizational Learning,* and author of *The Fifth Discipline,* changed the way FPG relates to systems. Senge would almost certainly encourage franchisors to alter and expand the way they think about systems. For example:

- Who are the top performing franchisees? What did they learn, see, or skillfully execute differently than other franchisees? How have they altered, adapted, or transcended the franchisor's business model in a way that other franchisees can learn and benefit from?
- What is occurring in the training and ramp-up program that creates a wide distribution of results? How can the support team move the entire bell curve to the right?
- What breakdowns occurred in franchisee recruitment that prevented underperformers from being recognized as such during the recruitment process? Which franchise salesperson brought in the top performers? Which franchise salesperson brought in the weakest performers?



Senge would encourage franchisors to gather all constituencies together to understand what Senge would call "The Desired Outcome." The desired outcome in franchising is always to create a profitable, valuable, sustainable, and growing brand.

A brand's value would ultimately be stretched across its ecosystem of franchisees, employees, shareholders, officers of the franchisor, key strategic vendors and suppliers, and of course the brand's customers.

The system would then be defined as how the franchisor, franchisees, key strategic vendors, and suppliers work together to create a high-value brand to the customer and strong returns to all brand constituents.

The Quality of the Franchisee-Franchisor Relationship

Franchisee-franchisor relationships must be trusting and workable. We will define workable relationships in greater detail in the upcoming section about corporate culture.

Lag and Lead Indicators of Franchisor Health

A lag indicator is a key metric that tells you what occurred. As stock brokers are prone to say, "Past performance is no guarantee of future results." A franchisor that primarily bases strategic decisions on lag indicators is driving a car by looking squarely in the rear-view mirror.

Lead indicators best represent where the brand is predictably heading in the near future and how close the franchisor is to creating or maintaining its flywheel effect. Franchisors understand their lag indicators, so FPG sees no need to address them here. We will focus this section entirely on lead indicators.

FPG believes the list below to be the most accurate franchisor lead indicators. Consider this list a broad outline. It in no way represents a complete list of lead indicators for any one brand. More than likely, each brand may have its own unique set of indicators which needs to be explored and measured.

Common lead indicators include:

- **The franchisees' most current financial results.**
    - Unit-level economics
    - Customer traffic
    - Average ticket
    - Net promoter scores

- **The capacity and skills of the leadership team.**
    - Are they able to correctly identify opportunities and set strategies to capture a disproportionate share of the available market?
    - Have they ensured the brand is unique in the marketplace, profitable, valuable to the customer, and defensible against competition?
    - Do the products, services, brand, delivery methods, and value proposition appear relevant and valuable into the foreseeable future?
    - When potential competitive or disruptive threats arise, can the franchisor identify those threats and create strategies to defend against them.
    - What is the franchisor's ability and capacity to act as an internal consultant, identifying and capturing opportunity?
    - Does the executive and leadership team have the organizational skills, vision, and capacity to successfully navigate the next inflection point in the franchisor's life cycle? Is each VP and C-level executive up to the demands of their role and responsibilities in the next growth stage? Do they have experience successfully navigating brands through the growth curve on their watch?

- **The quality and workability of the franchisee-franchisor relationship.**
    - Do franchisees have the skills and resources it takes to stave off competitive threats?
    - Are franchisees willing to invest the time, money, and energy it takes to defend against threats?
    - Right this second, are franchisees willing to be led by the franchisor? Do they trust in leadership and believe their interests are aligned with the leader's vision and stated direction?

- **The trajectory of the industry**
    - Is the industry growing faster, at the same pace as, or slower than the economy?
    - What disruptive forces or technologies exist now or on the horizon?

- **Competitive forces**
    - What is the existing competitive set?
    - **How do we stack up against the newest entrants into the category?**
    - **What, if anything, new is occurring with the competition?**
        - Private Equity injections

- Leadership changes
- Strategy changes
- Product or service offering enhancements

Keep in mind, the winning formula that helps a brand grow changes from stage to stage. For instance, the same tactics and team that work together to lift a brand from Early Stage to Emerging Growth often become an obstacle preventing franchisors from elevating from Emerging Growth to Regional Brand. Many franchisors become victims of past successes, doubling down and executing more of what has always worked in the past, instead of designing the brand for what it needs to be in the future.

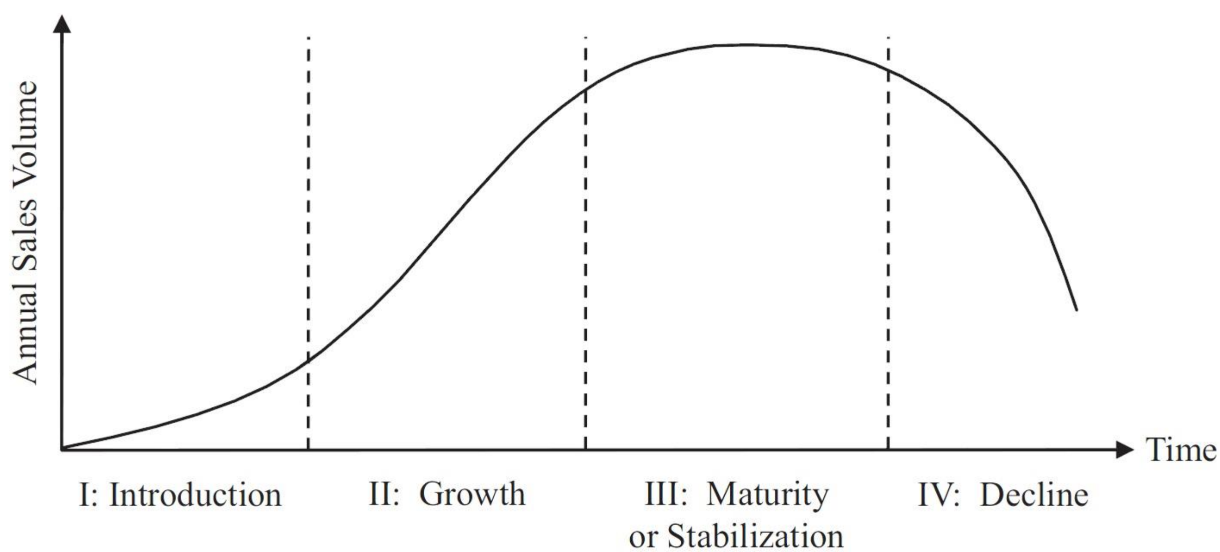
Therefore, franchisors must consistently evaluate their existing position through the lens of how the brand needs to look and function in the next growth stage. They must maintain a steady discipline of identifying who and what is missing and possess both the capital and organizational fortitude to layer in those recognized missing pieces.

FPG FRANCHISE BRAND GROWTH CURVE© DEFINED

Regardless of the service, product, investment level, or industry, all franchise brands seem to track along a common brand growth curve, with predictable stages that need to be successfully navigated in a predictable fashion to maximize opportunity.

The FPG Franchise Brand Growth Curve© stages are linear, sequential, time-limited, and highly predictable if one knows where to look.

The growth curve somewhat mirrors economist Raymond Vernon's famed product life cycle. Vernon discovered that, while the opportunity timeframe and sales volumes aren't consistent from product to product, the relative path is identical.



The key to managing a product life cycle becomes first knowing where the product is in the life cycle and then correctly employing human and financial capital relative to the needs of that particular stage.

For instance, during the introduction stage of Vernon's product life cycle, a company needs to focus on marketing to build brand awareness, engage customer trials, grow a customer base and gather market share. During growth, a company runs hard, seeking to establish a dominant position and maximizing the opportunity by outpacing the competition. During maturity, sales soften, companies defend existing market share, protect existing customer relationships, and seek to extend profitability by keeping products relevant as long as possible. During decline, companies phase out or sell off the declining product lines, and then acquire or create new products and services and start a new product life cycle.

Notice how **the unique dynamics and demands of each stage dictate and determine the**

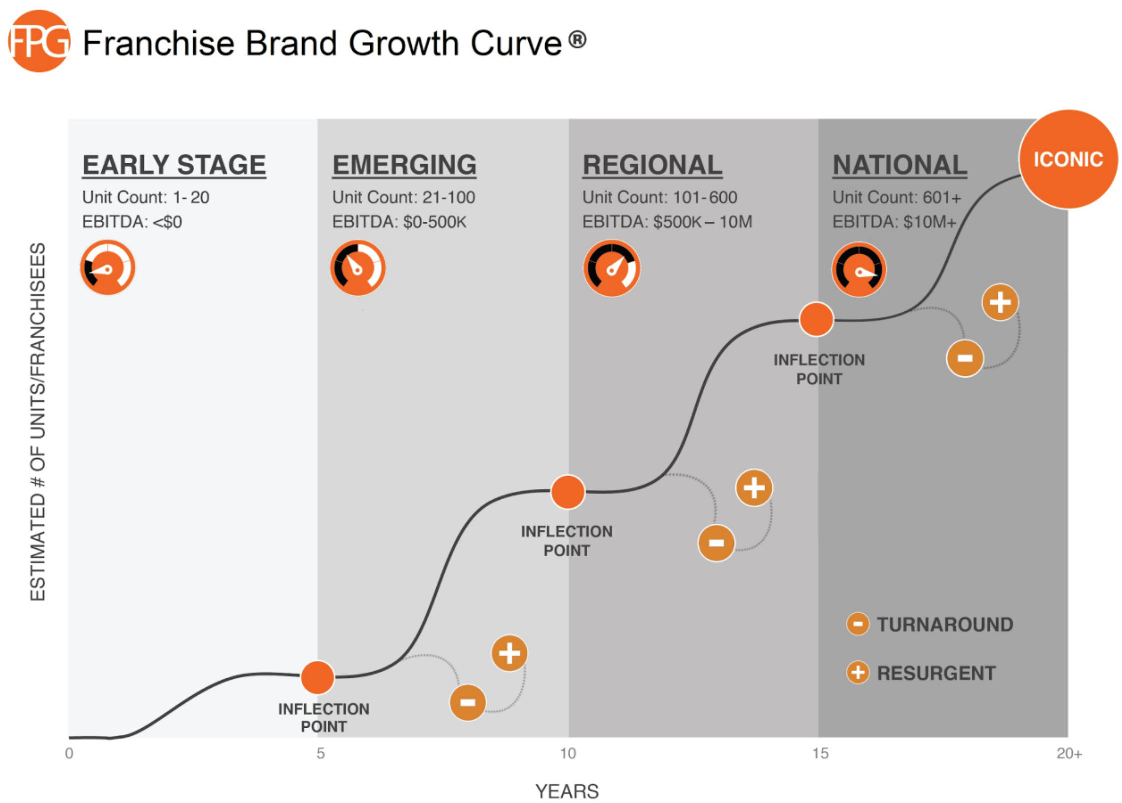
company's brand strategy.

Rather than a smooth continuous curve like Vernon's product life cycle, the FPG Franchise Brand Growth Curve© is a bit more complex. During each stage, franchisors face potential points of diminishing marginal returns, eventually leading to leveling or decline if they don't skillfully implement the strategies relevant to that stage while at the same time planning for the next stage. The franchisors who successfully navigate all stages will ultimately capture a dominant leadership position and be assigned the premium valuation that private equity and strategic acquirers reward to market leaders.

Again, FPG asserts all successful franchisors are highly skilled in two dominant arenas:

1. Driving unit-level economics
2. Building and maintaining a culture of trusting and workable franchisee relationships.

As franchise brands move through each stage, unit-level economics should continually improve, financial predictability increase, and risk decrease. The franchisee relationships and corporate culture will evolve from an informal entrepreneurial culture to a more formal yet collaborative corporate culture which values relationships and performance in equal measure.



FPG asserts all of the nearly 4,000 franchise brands can ultimately be bucketed into seven possible stages: Early Stage, Emerging, Regional, National, Iconic, Turnaround, and Resurgent.

These stages reflect where a company is within the business of franchising and doesn't always reflect the lifecycle stage of the products and services they offer customers. While the franchisor and product life cycles may be related, these life cycles need to be considered separate and distinct.

Early Stage. These are essentially startup franchisors. While they may be highly mature local or regional brands, they have not yet proven themselves successful.

Emerging. Franchisors have proven themselves on a small scale. Their initial group of franchisees are succeeding and expanding. The franchisor starts to grow at a more accelerated rate.

Regional. Franchisors have proven themselves in multiple markets. Their target franchisee, by most statistical measures, would declare their businesses financially successful. More cautious, better capitalized, and growth-minded franchisees come into the chain at a faster pace, creating a system tipping point.

National. Franchisors have successful market penetration in most major media markets within the United States. Brands look to achieve critical mass in each major market.

Iconic. The brand, now dominant, disruptive, or game-changing, is deeply embedded in the American culture. Think McDonald's, Subway, Dunkin'. In many cases, these brands define their categories, set the customers' expectations for competing brands, and determine the brand standards for all competitors.

Turnaround. Franchisors that do not successfully execute strategies relative to the stage they're in, whose unit-level economics do not improve as the chain expands, and whose franchisee relationships become strained will first experience a slow-down, and if corrective measures are not taken, sales will flatten and eventually decline, threatening the long-term stability and existence of franchisees, franchisors, and the brand.

Because of the typical 1- to 2-year lag time between the franchisor's strategic decisions and the impact of these decisions on the growth curve, many Turnaround brands don't yet know they are Turnaround brands. Often franchisors mistakenly think they are Early Stage or Emerging Franchisors because the data hasn't shown otherwise. We will discuss this time lag later in this work.

Resurgent. Franchisors who know they are in a Turnaround, who correctly identify root causes, who implement countermeasures, who halt the decline, and who start the slow reversal can become Resurgent brands. They often present themselves to the franchisees and customers as re-invented brands. Arby's is an example of a successful Resurgent brand.

Key Inflection Points

During any stage, franchisors may suffer from The Peter Principle. Consultant Laurence Peter coined this phrase in 1969 to describe a predictable organizational behavior pattern in which companies promote managers and employees until they fail. Peter described this as “rising to their level of incompetence.” Paradoxically, Peter found the main cause of failure for a manager or employees was their past successes. When placed in a new situation, managers and employees habitually implemented what worked in their last role, regardless of the appropriateness for their new situation. Rather than acknowledge and study the changing landscape and adapt accordingly, many people simply keep going with what they already think they know. Until they fail.

Inflection points represent the point in time where franchisors start to “peter out” and have to pivot, making decisions and applying resources which address the needs and issues they will encounter during the next stage. Too often, franchisors continue to make the same decisions that worked in their current stage and eventually fall off the growth curve and become the next Turnaround brand.

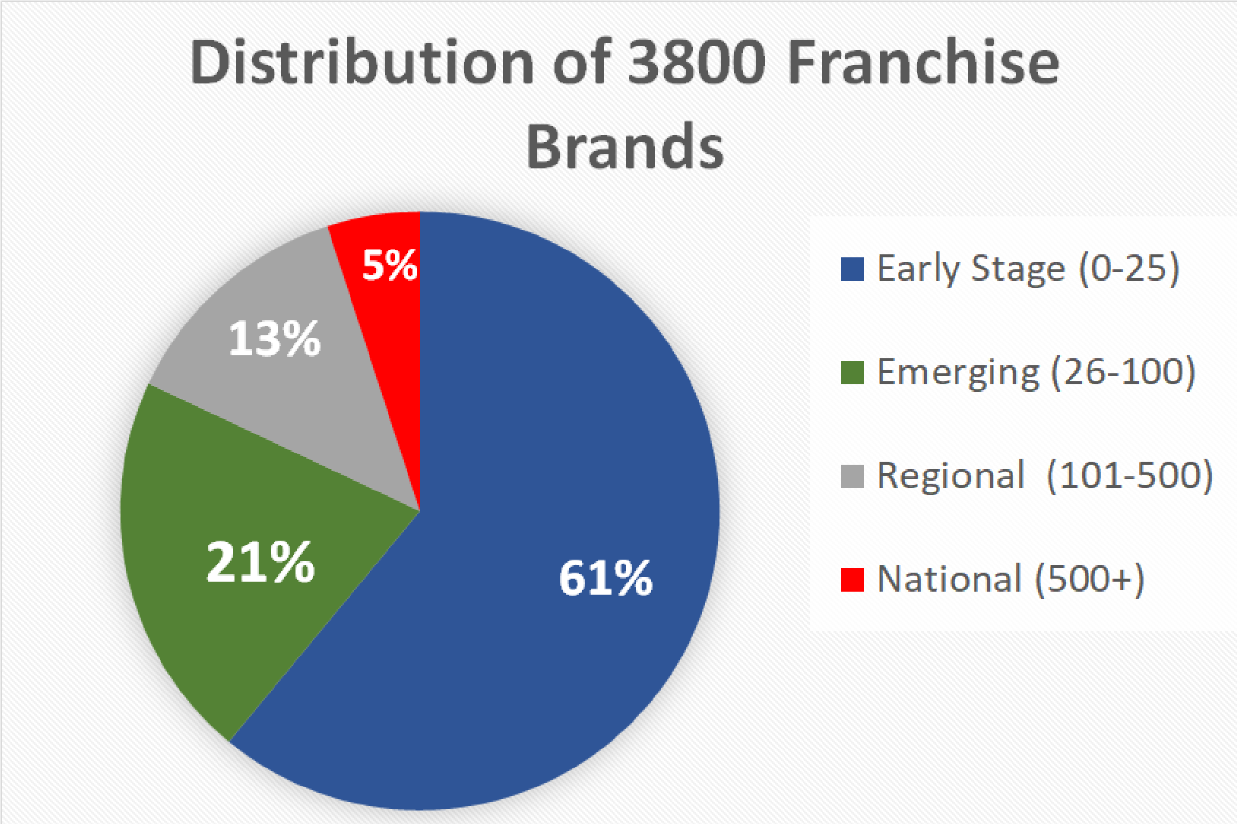
The key takeaway is that the franchisor’s mindset and tactics which worked so beautifully in the previous stage now become a barrier of entry to the next. If a franchisor doesn’t make a tactical shift, they will predictably peak and then decline. Because of the common 1- to 2-year lag between the time strategic decisions are made and the impact of these decisions on the curve, franchisors need to pivot before the data proves they are “petering.”

Just as each stage of Vernon’s product life cycle dictates strategy, each stage of FPG Franchise Brand Growth Curve© dictates strategy. If the strategy is mismatched to the stage or if franchisors are slow to make new decisions, growth will peak, and sales will flatten. If the brand continues along the same course, it eventually will slip into decline unless the franchisor takes corrective action.

Distribution of Franchise Brands by Growth Stage

According to FRANdata’s 2017 research, out of approximately 3,800 franchise brands that exist, 82% fall into the categories of Early Stage or Emerging (brands with less than 100 units or territories). Only 13% fall into Regional Franchisor (100-500 units or territories), and 5% of brands are classified as National or (500+ units or territories). Keep in mind brands can also be classified as Turnaround, Resurgent or Iconic at any size.

FPG models show it takes most franchisors 40 to 100 units to achieve royalty self-sufficiency, meaning the franchisor can sustain operations on recurring revenues alone rather than depending on one-time franchise fee cash influxes. Therefore, approximately 82% (represented by the green and blue areas in the following graph) of all franchise brands lack financial stability and could be classified as at-risk.



FRANdata 2017

Some franchisors think they should sell franchises as quickly as possible and then get out before operational problems surface. However, smart acquirers like private equity investors measure a franchisor's value against the predictability of future recurring revenue streams. Smart private equity firms can spot an unstable pump-and-dump, franchise-as-fast-as-you-can operation by examining sales volumes and predicting franchisees' unit-level economics. If franchisees' returns appear weak, PE will assume these royalty streams are at-risk and devalue the franchisor. The PE market wants financially sound franchisees who will predictably pay royalties for the duration of their agreement and renewal periods.

EARLY STAGE FRANCHISORS

Early Stage franchisors start as successful local concepts, typically with fewer than 20 operating units, locations or territories. While they may have demonstrated proof of concept for their corporate operating business model, they struggle with establishing proof of concept as a franchisor. Better capitalized and more sophisticated franchise buyers already know about the high failure rate for both Early Stage franchisors and pioneering franchisees, and therefore sit on the sidelines and watch.

According to FRANdata, Early Stage franchisors represent more than 60% of franchisors in the U.S. marketplace. According to the data, it would appear *only one-third successfully graduate from Early Stage to Emerging Brand status*.

Early Stage Best Practices

Franchisors who successfully navigate past the Early Stage inflection point and accelerate into the Emerging Growth generally share many of the following characteristics:

1. **Market timing.** They do business according to the adage, “Go slow to go fast.” They invest time and resources to battle-test and prove out their processes and systems over multiple territories and locations, leading to consistent, predictable, and acceptable financial results consistent with the expectations of their target franchisee investors. They operate multiple locations or territories for at least 5-7 years before franchising, demonstrating long-term sustainability across markets.

2. **They develop a brand of demonstrable value.** Because they are intelligent and sophisticated considering their size, they can entice pioneering franchise candidates to take a risk. Often these franchisees are regular customers, suppliers, or extended family, with the common denominator being they all have strong familiarity and general affection for the brand.

3. **They take the time to build a strong foundation.** They look long and award franchises cautiously, understanding in the Early Stage every franchisee needs to win. They carefully manage franchise candidates’ expectations up front, giving them a clear understanding of what it takes to win and getting commitment they are willing to do what it takes. Pioneering franchisees understand their place in brand history and accept responsibility for evangelizing the brand to qualified franchise candidates. The franchisee-franchisor relationship starts on extremely strong footing.

4. **They are capitalized properly and invest wisely.** They have access to a war chest in the $1 million-$2 million range and understand that’s what they may need to invest in infrastructure and brand refinements before achieving royalty self-sufficiency and

organizational stability.

5. **They accept and implement sound advice from franchising professionals.** Just as they tout the value of experience and the risk of doing it all yourself to franchise candidates, they in turn invest time and dollars putting together an advisory team with real-world franchising experience in growing successful franchise brands.

6. **They recruit selectively.** They critically think through what it takes to be a successful franchisee and are prepared to walk away from candidates who don't measure up. On the support side, they take their time hiring the best talent, people who share their values and have documented success in supporting franchisees and adding value to their brand.

7. **Leadership designs and executes their strategic plan.** Key employees and leaders often have mastery-level expertise in the multiple domains they're responsible for. If they don't, they hire consultants or advisors who bring this experience and bake this expertise into their processes and systems.

8. **New market penetration strategy has proven effective.** The franchisor has mastered and optimized all aspects of their new customer acquisition and revenue model, including necessary advertising vehicles and predictable targets for cost per new customer acquisition, customers' dollars-per-transaction, customer frequency and customer retention.

9. **Leadership is tech-savvy and uses technology to drive information and efficiencies.** The business leverages the latest and best technology effectively for their customer-facing and franchisor-related business systems.

10. **They already look and act like a national brand.** Branding and systems are highly refined. Scalable strategic vendor relationships are in place. Supply lines are negotiated and scalable. Leaders are high-capacity executives. The chain grows to fill slack organizational capacity rather than always playing catch up. The organization always hires, trains, and develops team members to increase slack capacity. They resist every urge to cut corners. Instead of buying into the logic of "let's launch into franchising with what we have and evolve and develop the brand over time," they think, "Let's launch with the best version of ourselves."

11. **Strong brand position.** The customer value proposition is clear. The target audience is defined and sees high value in the product or service offering. The brand has established raving fan customers in the markets it serves. Other customers are aware of the brand and appear to be anxiously waiting for the brand to enter their market also.

12. **Brand identity.** The brand is well known to the customers in the markets it serves and has some reputation and awareness in contiguous markets or nearby cities.

13. **One or more members of the leadership team has already been there.** One or more partners or executives has already built a regional or national chain with 200 or more territories or franchisees on their watch. They know what to expect when a chain hits tipping and inflection points.

If a franchisor successfully matures the brand, demonstrates the characteristics above, and successfully recruits, trains, develops, and leads a small but elite band of 20 or so profitable franchisees, the franchisor graduates from Early Stage into Emerging Growth franchisor status.

Franchisors who graduate will begin to attract an additional group of investors FPG labels Early Adopters. These candidates are generally more risk-averse than Early Stage pioneers but equally growth-minded. By widening its appeal to now include a strong secondary group of Early Adopters, the brand is poised to hit its tipping point.

Early Stage Risk Factors

Many franchisors fail to reach their potential not because of competitive threats, but because of the following:

1. **Self-deception.** Early Stage franchisors often view their business from an insulated insider's perspective, rather than looking at the business from a more classic supply-and-demand, industry, and franchise candidate/investor perspective. While the business format may have worked for the owner, the systems, training, or support may have undetected weaknesses, omissions, or flaws which inhibit a franchisee's ability to learn the model and aggressively grow.

2. **Undercapitalization.** Franchisors often falsely believe they can grow their companies using franchise fee revenue. Only when it is too late do many learn they will need to make significant investments in personnel or brand and system refinements prior to generating any significant return on franchise fees, royalties, or rebates from franchisees' product purchases.

3. **Low will.** Many franchisors want to capture the value without doing the heavy lifting necessary to refine their model and making it more marketable and valuable to prospective franchisee candidates. Sometimes they think that they can make more money selling $40,000 franchises than they can selling their products and services. These "take the money and run" franchisors are seldom concerned about franchisee support, long-term franchisee financial health, or building a sustainable brand.

4. **Bad or no market intelligence.** They overestimate the demand for their business and underestimate their cost and barriers of entry.

Often, these brand founders think to themselves, “I did well. I put my kids through college and built wealth and cash flow. I’m no Ivy League MBA or Zuckerberg wunderkind, but I believe I can teach anyone to do what I do.” Coming to the table with an “If I did it, anyone can do it” perspective, they automatically assume their business could and should be a franchise. They enter franchising with unrealistic expectations and completely underestimate the time, money, effort, complexity and sophistication it takes to build a profitable and sustainable franchise brand.

Simply put, Early Stage franchisors often falsely assume that since their concept plays well in small venues, they’re naturally ready for a national stage.

Franchising appears to be stacked with franchise attorneys and franchise consultants who easily convince small business owners their business is highly franchise-able and perhaps the next big thing. Then they charge professional fees of $150,000-$250,000 or more to develop their systems and package a franchise for sale.

Statistically, Early Stage franchisors more often than not fall into one or more of the following predictable traps, preventing a successful franchisor launch.

1. **Timing.** They come out too early. Their brand is underdeveloped and their processes and systems are unrefined, leading to inconsistent, unpredictable and unacceptable franchisee results. While the systems may work well for ownership and company managers, they may not be granular enough for new entrepreneurs who have no experience in the industry. These system flaws extend the franchisees’ learning curve, burning precious cash.

2. **They overestimate the demand for their franchise.** The fish don’t jump in the boat as promised by the professionals who set them up as a franchisor. The unplanned shortfall of franchise fee revenue knocks the brand off plan.

3. **They underestimate the amount of time it takes to get established.** Several years in, they feel like they’re running in quicksand, questioning what happened. Remember, one recent study showed less than 5% of franchisors get to 100 units or territories in less than 10 years.

4. **They are undercapitalized.** They were told it takes $150,000-$250,000 to get started, but later find out they will need to invest an additional $1 million-$2 million before they achieve royalty self-sufficiency and organizational stability. They’re undercapitalized and simply bootstrap it. They need franchise fee revenue to pay the rent and keep the lights on. Often the franchisor siphons from profitable company store operations, putting the once healthy company operations at risk also.

5. **They reject sound, practical advice from professionals.** They believe they know better. On one hand, they espouse to franchise candidates the value of experience and the risk of doing it all yourself. On the other hand, they reject investing in real world franchising experience, choosing to go it alone.

6. **They receive bad advice or a poor work product from franchise attorneys and franchise consultants.** This adds to both franchisees' and franchisors' risk and reduces their chances for success.

7. **They recruit anyone who will buy their franchise.** They don't critically think through what it takes to be successful pioneering franchisees, don't have the discipline to walk away from unqualified candidates, or simply grab the cash because they are undercapitalized.

8. **Leadership wears too many hats.** They operate as a part-time franchisor and part-time unit-level operator, leaving no time to do either particularly well. Key employees often don't have mastery-level expertise in the multiple tasks they're responsible for, increasing brand risk.

9. **Their brand positioning may be too unrefined.** The brand promise may be too vague or confusing to attract new customers for the consumer-facing model and new franchise candidates for the business model. This confuses customers and may reduce customer trial and frequency, lengthening franchisees' ramp up and increasing cash needs and risk.

10. **New market penetration strategy may be undeveloped and ineffective.** The brand is an unknown entity outside local markets, which requires franchisees to invest more time and energy in marketing than perhaps they budgeted for. Often franchisors tell candidates they have to do community marketing, which can be code for "we don't have a proven marketing system nor the money to create it, so we throw marketing spaghetti against the wall and hope something sticks."

11. **Revenue model may be incomplete.** The franchisor may have not mastered their complete revenue model, lacking systems, operations, marketing, and support to simultaneously increase and optimize customers' dollars-per-transaction, customer frequency and customer retention.

12. **The business may be behind the technology curve.** The business may not be fully leveraging the latest and best technology effectively for their customer-facing and franchisor-related business systems

13. **Nobody on the leadership team has ever done this before.** Ownership and leadership are comprised of product and service technicians and small business owners who have never scaled a business across the United States. Growing a sizeable

business is theory for them. They don't know what to expect and won't see nuanced breakdowns as they are happening.

14. **Personal agendas trump strategy.** Due to rapid acceleration, what was a reasonably flat organization where everyone is a colleague starts to form organizational hierarchies, creating a power grab among immature and inexperienced middle management. They fail to realize that success is a buffet and as the brand matures, everyone wins. Instead, they relate to the brand's newfound success and opportunities as a zero-sum game where there are winners and losers within their ranks and their access to advancement is by stepping over colleagues. If these attitudes aren't effectively dealt with, a toxic culture where personal agendas reign supreme will cement, trumping brand values.

EMERGING BRANDS

Smart, capitalized and aggressive Early Adopters target such brands for investment. Among sophisticated franchise candidates, the thought process is, “I don’t want to be a pioneer. They get arrows in the back. I also don’t want the franchisor to experiment with my time and money.” They equate a franchisor’s Early Stage with unmitigated risk.” In their world, once a franchisor has it all figured out (which often means 20 or more units, territories and locations), they have an opportunity to step up and cherry-pick the most lucrative markets.

Once a franchisor successfully navigates through Early Stage, they will start feeling more momentum. In the Early Stage, it feels like the franchisor is pushing a boulder up a hill. In the Emerging Growth Stage, it feels like the boulder has crested the hill and is now starting to roll down the hill on its own power, which introduces a whole new set of operational issues.

While a franchisor may have mastered what it takes to successfully onboard up to six franchisees per year, they are suddenly faced with a new problem: How do we successfully onboard 12-30 new franchisees per year?

Growth fuels brand awareness, driving year-over-year revenues to historical highs. Added units provide the franchisor with greater purchasing power, driving costs down and creating more resilience and liquidity. Growth also helps the franchisor build its brand as an employer of choice, adding more responsible and talented workers on both the franchisee and franchisor levels. The franchisor continues to refine its model, shortening the time to break-even, value-engineering the investment level downward and negotiating better financing programs for startups and expansions.

Simply put, everything appears to be working better all at the same time. It’s right about this time that franchisors begin to believe they now possess what it takes to build a large national brand. ***The reality is that they have only enough steam to carry them to the next growth stage.*** As the FPG Franchise Brand Growth Curve suggests, they will eventually experience decreasing marginal returns as they approach the next stage. At this point, successful brands reinvent their organization again to capitalize on the opportunities presented to successful regional brands.

Emerging Growth Best Practices

The data showing how the current 3,800 brands are distributed by size suggests about half of Emerging Brands crack the code, find their way past 100 units or territories and graduate to Regional Brand status. Those who do will share many of the same following characteristics:

1. **Tight operations training and support.** Franchisors successfully design their training systems to ensure franchisees rapidly achieve competency in the necessary areas to

profitably meet and exceed their customers' expectations. In addition, their training has proven scalable, meaning the franchisor has successfully increased its new training class sizes to handle more growth without diminishing results. New franchisees often receive higher quality training than the pioneering franchisees, compressing their learning curve and more quickly accelerating past break-even. The franchisor's training and field support teams are in sync and make successful handoffs as franchisees drive through their learning curve, shifting their focus beyond learning the business to maximizing opportunity and profitability.

2. **Adequate capital structure.** The franchisor has the necessary funds to hire staff as needed, fund initiatives, and fix broken, unscalable, or antiqued processes and systems which may have worked in the past but aren't appropriate going forward. Many franchisors take 10 years or more to get to this stage of growth and haven't experienced much of a payback despite their efforts. Now the chain is heating up and money is starting to flow in at exponential rates. Some franchisors want to grab cash and take some chips off the table. However, this is the stage where franchisors often need to invest another $500,000 to $2 million in infrastructure and brand and system refinements to maximize the opportunity and set the stage for the next level of growth.

3. **Creating a learning organization.** The franchisor's team and existing franchisees battle-test systems, improve tactics, measure KPI's (Key Performance Indicators) and engage in continual improvement. They identify problem areas before they are strained. They acquire the domain-area expertise through either smart hiring decisions, outsourcing, or vendor relationships to ensure scalability while protecting key elements of the system and brand. Often franchisees identify and resolve systemic operational problems prior to the franchisor understanding the scope of a problem. Franchisees push their insights up and the franchisor incorporates these insights or techniques into operational best practices.

4. **They identify and eliminate brand disconnects.** Marketing elements, customer experience, and complete brand experienced are all finely polished and what you would expect to find at a large, national brand. Franchisees understand the brand, what makes it work, and are committed to skillfully executing their business consistent with the leadership's brand strategy.

5. **Collaborative leadership.** Franchisee-franchisor relationships have evolved past casual interpersonal relationships associated with Early Stage into more and more commercially-minded relationships. As the chain accelerates, leadership creates more professional boundaries. Early Stage franchisees begin to experience how growth is changing their relationship, and often they don't like it. Smart franchisors educate franchisees in advance how the culture will evolve and prepares them for change. It's critical franchisors minimize turnover at this stage, as royalty streams driven by mature franchisees fund much of the franchisor's growth initiatives.

6. **Protecting corporate culture.** Often to stay ahead of the growth curve, franchisors need to hire leaders and employees from other national franchise chains. Although their role demands that employees and leaders build the plane while they're flying it, the franchisor pays careful attention to protecting existing corporate culture rather than importing and inadvertently blending cultures from other chains, creating some loss of corporate identify. Often the chain will charge one person with being the culture czar, making sure organizational values remain intact and impact and influence the new

leader's or employee's decision making.

7. **Staying in communication.** During this stage, franchisors run at 100 miles per hour, with team members often not knowing what each other are doing. Successful franchisors resist the natural urge to silo and make sure teams are communicating cross functionally. Franchisors throw away their M & M's (meetings and more meetings) in favor of smarter communications and meeting protocols that ensure communication is on a need-to-know basis, eliminating hundreds of daily email cc's. Meetings become more streamlined and focused.

8. **Scalable supply lines.** Vendors scale supply lines and make strategic investments into the franchisor, franchisees, or their own infrastructure to get products to market faster and cheaper to help the franchisor maintain its competitive advantage and add more value for both franchisees and consumers.

9. **Engaging in systemic thinking.** Franchisors get off the one-off break-fix merry-go-round of solving franchisees' operational issues. Instead, they objectively ask questions, like, "Is this a franchisee error or a system shortfall?" "What is it about our operating systems or training that is contributing to multiple franchisees breaking down in the same place or complaining about the same issue?" Rather than spending most of their time and energy fixing one problem at a time, they take some time to study how the overall system may have created a series of individual breakdowns. Then they make the necessary patches, fixes, and upgrades and communicate it to the chain.

10. **Masterful marketing.** Franchisors begin to move from community marketing tactics to advertising co-ops in some markets, requiring a different level of marketing sophistication and greater coordination among franchisees. Franchisors and franchisees work together to leverage their numbers by pooling advertising resources to build name recognition in these developing markets, creating same-store sales increases and building name recognition in unserved neighboring communities, paving the way for easier penetration.

11. **They hone their competitive advantages.** Copycat concepts start emerging, picking at the franchisors' past value proposition in existing markets and new markets. Successful franchisors anticipate competitor knock-offs and have been investing time, money, and energy fine-tuning and perfecting their value proposition, leapfrogging the competition by creating a unique, profitable, valuable, and defensible customer offering.

12. **Increasing organizational capacity.** While it takes the personality, initiative, and drive of a founder/CEO to power a franchisor past Early Stage into Emerging Growth stage, sheer force of personality no longer works to drive small chains to become large regional or national brands. The same micromanaging and "jack of all trades and master of none" organization that worked fine in the Early Stage becomes a barrier to continued growth. The chain needs professional management and domain area experts in areas like adult education and digital marketing. The run-and-gun founder entrepreneur has transformed into a CEO who manages through objectives, strategies, and tactics and runs a quality organization — or the founder has brought in someone who does.

13. They value expertise. Franchisors create key strategic vendor relationships with suppliers and domain-area experts like supply chain, IT, and executive training and development. These experts are charged with identifying franchisor blind spots and increasing their field of vision, and identifying and eliminating potential problems before they occur, keeping the franchisor in growth mode.

Current market data shows that only 18% of total existing franchisors make it past the Emerging Growth Stage into Regional Brand status of 101-500 units or operating territories.

Emerging Growth Brand Risk Factors

1. **Overstretched operations and support.** Franchisors don't design their support systems to scale. New franchisees received highly-personalized attention and support in the Early Stage. Franchisors don't staff to provide the next wave of franchisees with the same level of support, often elongating new franchisee ramp-up and hurting unit-level economics. Staff often pull double duty, taking on roles within the organization beyond their pay grade or in areas where they have little experience.

2. **Undercapitalization.** Franchisors may take 10 years to graduate from Early Stage to Emerging and cannot staff up as necessary. They wait for added royalty and franchise fee revenue, staffing as cash allows rather than as growth demands. Cash-strapped franchisors can't fund necessary initiatives or fix systems buckling under the pressure of growth. They postpone certain fixes, hoping problems don't escalate and become unfixable downstream. The franchisor has difficulty securing expansion capital for themselves and may resist taking on private equity or expensive mezzanine financing.

3. **The Peter Principle.** Employees and managers are promoted based on their performance in their current role, rather than how well they are suited for their intended role. As franchisors struggle to stay organized, employees are often promoted past their point of competence, leading to downstream organizational breakdowns.

4. **Brand disconnects.** As the brand continues to grow, new and existing customers raise their level of expectations. They demand a more polished brand, efficient systems and a more unified and cohesive customer experience. This means greater investments from both the franchisor and franchisees, often before they have reaped a strong return on existing investments. Since it may take a brand 10 years to graduate to this stage, the original concept may have outdated branding and systems, making the brand look fractured and obsolete.

5. **Leadership.** Franchisors often have highly personal and informal interpersonal relationships with franchisees in the Early Stage. As the chain accelerates, leadership creates more professional boundaries, such as not taking a franchisee's call on a Sunday afternoon. Early Stage franchisees begin to experience how growth is changing their relationship, and often they don't like it. Many decide to exit at this stage, thinking, "The culture changed. This isn't the system I bought into."

6. **Corporate culture.** Struggling to keep up with growth, franchisors begin hiring leaders and employees from other franchise chains. Because the role demands that employees and leaders build the plane while they're flying it, they never learn or acclimate to their new franchisor's culture. Instead, they solve problems, manage, and lead the way they did in their previous corporate culture. This often creates a breakdown with franchisees and with valued existing employees, creating franchisee confusion and dissatisfaction and franchisor key employee turnover at a time when the brand is counting on its experienced employees to step up and take on more.

7. **Lack of communication.** In over 30 years of franchising, I have never heard a franchisor or franchisees of a rapidly growing Emerging Growth franchisor say, "You know what our problem is? We over communicate!" Franchisors run at 100 miles per hour, often not knowing what each team member is doing. This lack of communication can create relationship fractures and isolated work silos that often don't integrate well into the franchisor's overall brand strategy.

8. **Supply lines.** Some vendors may be having a hard time keeping up. Other vendors start raising their prices, thinking it is an opportune time to start reaping the benefit of your success. Some suppliers may have a hard time getting products to new markets, putting a burden on new market franchisees, often charging transportation costs that weren't planned for, driving up COGS, increasing time to break-even, and increasing risk.

9. **Lack of systemic thinking.** Franchisors get caught up in a one-off break-fix mentality, spending most of their time and energy fixing one problem at a time rather than studying how the overall system created a series of individual breakdowns. Franchisors work on the franchisees' symptoms but ignore the systemic breakdowns that created the symptoms in the first place. Often, they blame their problems on poor franchisee attitudes and execution before they look at the quality and scalability of their systems or the skills and experience of their employees.

10. **Marketing.** Franchisors begin to move from community marketing tactics to advertising co-ops in some markets, requiring a different level of marketing sophistication and greater coordination among franchisees. Franchisors may pull the trigger on additional marketing co-op fees guaranteed to them under the terms of the franchise agreement. Franchisees may push back, not seeing the value.

11. **Increased competition.** Copycat concepts start emerging, threatening the franchisor's value proposition in existing markets and making it more difficult and costly to enter new markets. They watch the market and design business models which appear to fix the problems which hamper the market leaders.

12. **The founder's trap.** It takes the personality, initiative, and drive of a founder/CEO to power a franchisor past Early Stage into Emerging Growth Stage where the chain gathers momentum. It's toward the end of the Early Stage where the sheer force of

personality no longer works. The founder needs to elevate to CEO and build an organization that drives results. The micromanaging that worked in the Early Stage becomes a barrier to continued growth in Emerging Stage. If the founder can't elevate into a CEO who manages through objectives, strategies, and tactics and runs a quality organization, then the franchisor will begin burning out its valued employees and have difficulty attracting new talent. The market will only give the organization what the organization has the will and skills to handle. Additionally, many entrepreneurs start business because they don't function well inside of corporate environments. As the chain grows, these entrepreneurs find themselves having to create the same corporate structures they swore they'd never be a part of again. This "I must become what I despise" mentality creates organizational stress, resistance and conflict.

REGIONAL BRANDS

Regional Brands have successfully expanded beyond their core markets, established multiple beachheads in previous virgin territory, and achieved the same level of success in new markets as in their core markets. These franchisors have proven they have high value products and services, a replicable market penetration strategy, and demonstrated success accelerating new franchisees through their learning curve into high levels of competency within a shortened time frame. Simply put, their model is both successful and replicable.

Regional Brand does not confine itself to geography like Northeast or California; it means the brand is well established in multiple markets, but not in every region.

The franchisor's leadership team has transitioned the company from an informal entrepreneurial run and gun, benevolent dictatorship to a more professionally managed organization with goals, objectives, financial plans, and budgets.

If the brand remains current and the team is built right, the organization will continue to scale rapidly until unit-level economics weaken, systems become strained, or the organization stretches beyond capacity.

Franchisors have a tendency to constrict to receive only the growth they can prove to handle. Out of the current crop of franchisors, only 18% have successfully crossed over into Regional (13%) or National brand (5%) status. Please keep in mind most franchisors were already 20 years old when they crossed over, competing in a time where there was less competition from franchise concepts, less government regulation, and fewer barriers to growth. Given today's more restrictive and competitive environment, had they started within the last 10 years, many of these chains would have been stymied in the Early Stage and Emerging Growth stages.

Brands and leadership that successfully navigate the Regional Brand inflection point without detonating one of the landmines listed later in this chapter often experience smooth sailing to critical mass, which is often 700 to 3,000 or more locations or operating territories, solidifying their position as a formidable, category-leading and possibly category-killing national brand.

Regional Brand Best Practices

The natural progression of a well-run Regional brand is towards growth. Customers, staff, vendors, franchisees, and other brand stakeholders act in a concerted effort to ensure the brand thrives. Seemingly everyone wants the brand to win, and so it does. Customers eagerly wait for the brand to open within their respective communities, so it eventually does. Growth is natural and unforced. The chain enters into a predictable and natural growth rhythm.

Companies who cross the inflection point have many of the following elements in common, working in synergy to give the brand strong tailwinds, propelling it towards National and Iconic brand status.

1. **Strong organic growth.** Existing franchisees are expanding and often represent 50% of the brand's new unit growth every year. Existing franchisees are easier to support, creating higher franchisor margins on recurring revenue dollars. If the franchisor were to stop investing in new franchisee recruitment, the chain would still achieve critical mass through the expansion efforts of existing franchisees.

2. **Mass marketing expertise.** The brand pools advertising dollars and develops high functioning and strongly supported regional advertising coops which buy mass marketing opportunities (TV, cable, radio, etc.) that build brand awareness and move the sales needle by increasing customer trial and frequency. Increased awareness translates into pent-up customer demand in unserved markets, creating easier and less costly new market penetration.

3. **Strategic lending relationships.** Based on the franchisees' track record for loan repayment, banks give favorable terms and easy access to funds to franchisees. This makes capital easier to access for new startups, expansion for existing franchisees, resales, remodels, fleet leasing, and other needs.

4. **First consideration for available real estate.** Based on franchisees' positive track record within the real estate community, the brand becomes a desired tenant and earns first consideration for high value real estate.

5. **Strategic vendor relationships and preferred pricing.** Franchisees receive price, terms, delivery, and other key advantages vendors offer other national chains and market leaders.

6. **Results rather than politics.** The franchisor's executive leadership and employees see opportunities and upward mobility for all. Managers and leaders don't jockey for position because the rising tide raises all ships. Key employees experience profit sharing or equity opportunities and start thinking like CEOs and owners.

7. **The brand has a life of its own.** The brand has created its own identify, often grander than founders and leadership originally imagined. Customers, vendors, employees, and franchisees all build relationships and develop an affinity for the brand on their own terms. Customer brand fans seemingly make it their mission to drive brand awareness and customer trial through their own networks and communities. Every marketing piece, customer touch point, and brand experience seemingly echoes the brand's identity and reinforces its value proposition.

8. **Contributions come from everywhere.** The brand occurs as a "brand of destiny." People and resources show up in unpredictable ways to make significant contributions, addressing needs and solving problems the brand may not have been previously aware they had.

9. **The brand is universal.** Customers in every geography can identify and relate to the brand's value proposition and see high value in the offering.

10. **New customers are waiting.** The brand's reputation precedes itself. Franchisees walk into new markets with strong brand equity often where customers have already tried the products and services.

11. **Systems are scalable.** The brand is limited only by franchisees' management capacity. The unit level returns are strong enough for the franchisees to build internal infrastructure to support unit level operations.

12. **High barriers to entry and defensible position in the marketplace.** Franchisees are offering something unique, valuable to their customers, and difficult to copy. This creates a long-term sustainable advantage in the marketplace. The brand is not under any significant threat of competitors stealing market share or commoditizing the marketplace.

13. **Fish jump in the boat.** The word is out that the brand has created a unique and valuable investment opportunity and smart and aggressive franchise candidates want in. Because franchisees continue to expand, opportunities are scarce, creating a strong secondary market for franchise resales, and high premiums and demand for open development territories. Franchise candidates move quickly through the recruitment process fearing loss of opportunity.

Regional Brand Risk Factors

Regional Brands often find themselves in no man's land. If they aren't a category leading brand, they don't have the budgets to compete yet with the larger national chains. Yet they are large enough that they can no longer fly under the radar screen. Unless they have high barriers to entry or a defensible position in the marketplace, copycat concepts will emerge in their open markets, making it more difficult and costly for them to penetrate these markets. If they have a signature product, often the larger brands will introduce a similar product to steal market share and to make it difficult for the brand to expand.

1. **The brand, products, or services become dated or irrelevant.** Brands who successfully cross over into Regional Brand status generally have been in business for more than 10 years and often more than 20, meaning the brand, product, or entire business format may need either a refresh or total brand overhaul.

2. **Overstretched operations and support.** Regional Brands often need the same domain area experts as National Brands but struggle to recruit the same level of talent. Senior executives of National Brands would consider working with a regional brand as perhaps going backwards in their career. Often Regional franchisors find themselves reliant on high-potential but unproven director-level talent looking to jump to the next level, creating

brand risk.

3. **Increased competition.** More sophisticated copycat concepts entrench in the franchisor's untapped markets, making it more difficult and costly to enter new markets. Franchisors in this stage are often niche regional players competing in a category where first mover position has already been achieved by one or more other brands. If the Regional Brand does occupy the first mover position, smart Emerging Growth copycat concepts will study the shortcomings and fatal flaws and then launch with a more modern concept incorporating strategic fixes into their brand and operating systems.

4. **Mass exit of mature franchisees.** Many longtime franchisees have seen the brand evolve significantly, and they often need to make significant investments to stay relevant. For instance, the franchisor may have changed their current look and offering, market expectations may have shifted, and competition may have changed the game. Rather than make these investments, many mature franchisees look to cash out. The chain loses hundreds of years of irreplaceable institutional knowledge in the process. Resales of these existing locations often cannibalize growth. Franchise candidates who would have entered new markets choose instead to buy locations from mature franchisees exiting the brand.

5. **Brand disconnects.** As the brand continues to grow and enter new markets, customers are treated with the latest and greatest version of the brand. Often the franchisor's core market becomes plagued with outdated versions of the brand and product and service offerings, confusing and dissatisfying customers who have become accustomed to something newer or different. Huddle House originally suffered an inconsistent brand image because of outdated locations before new leadership successfully engineered a turnaround and brand resurgence through an aggressive remodeling incentive and financing programs.

6. **The franchisor ownership cashes out and new owners don't understand franchisee-franchisor relationships.** Private equity has been entering franchising at unprecedented rates, paying enticingly high multiples of earnings and creating a significant payday for ownership. Changes of ownership create changes in leadership, culture, and priorities. PE often underestimates the necessity of generating franchisee buy-in and adopts a highly-centralized command-and-control leadership style, pushing down on the organization to drive their agenda. This creates franchisee and franchisor friction that may not have previously existed. The heavy thumb of the leadership team may also create senior leadership turnover as these professionals would be in high demand from other Emerging Growth, Regional, and National chains. Turnover creates consternation and disruption among franchisees and middle management. If ownership is looking to sell, they may be running lean in order to maximize EBITDA and resale value, leaving new ownership to make these investments.

7. **Franchisee advertising coops mismanaged.** In earlier stages, franchisees are accustomed to managing local budgets and doing their own thing in a vacuum. As brands grow, franchisors often pull the trigger on clauses in franchise agreements that can force advertising coops to form without the buy-in of franchisees — effectively taxing franchisees with an additional royalty they may have not budgeted for, creating an immediate loss of significant net income and disrupting their operations. Often franchisors pull the trigger too early, hoping to create brand awareness for easier penetration into unserved markets, but offering little benefit to many franchisees who may not be expanding in the near term.

8. **Decentralization and siloing.** Often franchisors open regional offices and push power and control of budgets and tactical execution down to managers of local regions. These director-level or Regional VPs may not have the executive leadership pedigree of those who manage them. This results in on the job leadership training at franchisees' expense. Often these new leaders, who no longer physically report to the corporate office, start forming regional cultures, such as command and control or local "dictatorships," creating regionally fractured franchisee-franchisor relationships and corresponding franchisee resistance and operational breakdowns. Conversely, franchisors can assign regional leaders' responsibilities but provide no budget or authority to carry out initiatives. This "responsibility with no authority" no-win situation will disempower key leaders, eventually creating turnover in the senior ranks and disruption to franchisees.

9. **Misreading the tea leaves.** Officers do not understand the lag and lead indicators of brand performance, and effectiveness is measured almost entirely by revenues and profitability, with little effort put into measuring and improving the workability of franchisee-franchisor relationships. These relationships drive execution and future revenues.

10. **Strained supply lines.** Some vendors may be having a hard time keeping up with supply lines and may reduce the number of deliveries to outlier markets. Other vendors start raising their prices. Others don't service new markets which means franchisees pay higher shipping costs, reducing franchisee margins in new markets. Keep in mind, this occurs at the same time sales are softer due to lack of brand awareness franchisees experience in new markets. Strained supply lines extend the timeline of franchisee break-even, depletes capital and adds unmitigated risk to their investments.

11. **It doesn't play in Peoria.** Franchisors and new franchisees overestimate their brand's universality and thus overestimate demand in new markets. They may also underestimate the effect of changes in seasonality, local economic conditions, the strength of local or regional competitors, and changes in customer preferences or expectations by geography.

12. **Departments silo, and the brand becomes fragmented.** At this stage, franchisors hire domain-area experts and reduce the brand down into functional areas like marketing,

training, operations, and finance. These departments have a tendency to silo and put out their version of the brand best practices relative to that function. Often these pieces aren't well integrated into the whole brand, creating a loss of brand synergy, identity, and brand magic — the intangible overall customer experience.

13. **Trappings of wealth.** Especially where there is original ownership, the brand is generating outstanding returns, so ownership may rest easy thinking, "we made it" and become complacent and risk averse. Leadership and shareholders, who often have not up to this point experienced the returns they expected, start taking significant cash out of the company to make up for their longer-than-expected return horizon. This, combined with an increase in ownership's desire to monetize their investment and possible decrease in their desire for reinvestment, adds risk to the long-term viability of the chain.

14. **Stepping stones.** Franchisor's new leadership hires may use the brand as a short-term stint to pad their resume while planning for what's next. High growth regional franchisors cannot afford the disruption of leadership turnover.

NATIONAL BRANDS

Brands with over 500 operating units and territories will have vast geographic coverage through most areas of the United States. Often their franchise development challenge is to backfill underserved existing markets rather than penetrating new. The brand is built. The franchisor's consumer value proposition is defined, as well as the markets they serve. The corporate culture is instilled. The organizational structure is built. Strategy and budget are set. The brand is profitable.

Out of the current crop of franchisors, only 5% can be classified as "National," which represents under 40% of the number of brands we classify as "Regional."

Since most franchisors operate in sectors with long product and service life cycles such as residential services, food, auto care, and business services, large national brands will stay dominant if they continue to execute the basics well. Smart brands will have created a signature product or service that defines the category, keeping brand top of mind with the consumer.

For those brands who take the time to refine the brand, perfect systems, drive unit-level economics and build out their infrastructure, it's now windfall time. Most franchisors become royalty self-sufficient, meaning they can fund payroll and initiatives and retire debt service entirely through royalty and other recurring revenues. As chains move into the National stage, it is not uncommon to see 50% of incremental royalty streams or more flow through to the bottom line. In addition, chains experience a premium valuation by equity firms or other potential acquirers represented below.

Those brands who maintain their market dominance and elevate to Iconic Brand status share similar characteristics.

National Brand Best Practices

1. **Organic growth.** Existing franchisees should continue to represent 50% or more of new unit growth and territory expansions. Existing franchisees are easier to support, creating higher franchisor margins on recurring revenue dollars. Many franchisors do away with the franchisee recruitment team at this point and focus on existing franchisee organic growth and supporting existing franchisees who act as brand consolidators, exiting underperforming franchisees.

2. **Mass marketing expertise.** Franchisors need to demonstrate consistent victories developing marketing campaigns which drive sales and protect existing customer relationships. Emerging Growth and Regional Brands can't compete on marketing spend, which creates high barriers to entry for these otherwise competitive brands.

3. **Strategic lending relationships.** Based on the franchisees' track record for loan repayment, the banks give favorable terms and easy access to funds.

4. **First consideration for available real estate.** Based on franchisees' positive track record within the real estate community, the brand becomes a desired tenant and earns first consideration for high value real estate.

5. **Preferred vendor pricing.** Franchisees receive price, terms, delivery, and other key advantages vendors offer other national chains and market leaders. They also may get added-value services such as free assembly or stocking of merchandise. They may get proprietary products or promotional materials such as movie promos. They also may get apps or other labor-saving devices to make it easier for franchisees to do business with vendors and provide a competitive advantage in the marketplace.

6. **Brand champions proliferate.** The brand developed an identify, often grander than the franchisor and franchisees could have originally anticipated. Customers develop a love, respect and personal relationship with the brand. Customer brand fans continue to make it their mission to create brand success and longevity within their networks and local communities.

7. **High emotional engagement.** Customers, suppliers, franchisees, employees of the franchisor, and other brand stakeholders want the brand to win. Therefore, they each add value back to the brand in their own way, from customer YouTube and Yelp testimonials to employee testimonials on GlassDoor.com.

8. **The brand goes international.** International customers who become familiar with the brand in the U.S. anxiously wait for the brand to become established in their country of origin.

9. **High barriers to entry or defensible brand position.** The brand offers its customers something unique, of high perceived value, and difficult to copy. This creates a long-term sustainable advantage in the marketplace.

10. **Suppliers compete aggressively for your business, creating advantages.** The brand has created a unique and valuable investment opportunity which attracts smart and aggressive entrepreneurs. Suppliers aggressively bid on the brand's business and offer terms which give franchisees a competitive position in the market and enhance the product or service offering.

11. **Employer of choice.** High quality leaders, domain-area experts, upwardly-mobile management and responsible employees seek employment opportunities on every level.

National Brand Risk Factors

1. **The brand, products, or services become dated or irrelevant.** Suppliers, merchandisers, and the franchisor may have become complacent due to a current dominant marketplace position. Risk aversion may be institutionalized, creating a formidable barrier to creativity, innovation, and new investments into product or service enhancements or extensions. Smaller, more aggressive chains will study the model, look for flaws, and attack the brand position from where the brand appears to be vulnerable. That's why smart national chains constantly move the brand from where they are now to where they want to be in the future. Competitors plan and attack the brand from where they have been in the past. Smart brands are moving targets.

2. **Leadership becomes too enmeshed in the past.** Dominant national brands sometimes invest too much time and energy looking at competitive threats and fixing perceived weaknesses from the past. These brands seem to think and act from only one year out. They do not allocate enough time, capital, and resources to evolve and enhance their model based on what it needs to look to maintain a brand leadership position five years into the future.

3. **Increased competition.** More sophisticated copycat concepts that design systems around the brand's perceived fatal flaws will emerge. For example, at one time Quizno's tried to exploit Subway's limited menu of hot subs. They aggressively grew their number of stores. Then Subway responded with a breakthrough piece of equipment that toasted subs faster than Quizno's "pizza slice" conveyor belt oven. Furthermore, Subway aggressively rolled out a $5 sub line, introducing a price point Quizno's could not profitably match. While this price leadership position may have hurt Subway in the long term, it proved enough to marginalize a rapidly growing competitor, sending it into a tailspin.

4. **Mature franchisees are no longer invested in growth.** Many mature franchisees in the National stage often need to make significant investments to stay relevant. Rather than make these investments to modernize the aging businesses, they elect to milk the business for as long as they can prior to selling. These franchisees often have made a significant return on their investment and now apply a minimal level of effort to achieve their minimal acceptable level of performance. When these franchisees exit, they take valuable industry domain area expertise with them. Others pass the business to family members who may not have learned the business from the trenches like the first generation of ownership and therefore can't fully appreciate what it takes to win. The second generation may not have the drive to do what needs to be done to keep the brand relevant.

5. **Brand disconnects.** As chains run out of new territories to open, often brand leadership is pushed to drive year-over-year same store sales to improve the franchisor's revenue line. Leadership may start introducing questionable product extensions or new services

that look like new incremental revenue opportunities to franchisor leadership but add complexity, expense, and create operational breakdowns for franchisees and are confusing to existing customers, such as McDonald’s failed McPizza and Wendy’s salad bar.

6. **Cycles of being bought and flipped by private equity.** Private equity has been increasingly investing in franchising by offering franchisors enticingly high multiples of earnings. Changes of ownership create changes in leadership, culture, and priorities that include how to flip the chain within 5-7 years for twice what they paid.

   Many PE firms don’t understand the business of franchising. They do know, however, that they can drive revenues by increasing royalty revenue collected. They also know they can contain costs by reducing services. Since the goal of PE is to sell the chain at the highest possible multiple — not to build a long-term sustainable brand — they often make a series of short-term decisions that can have damaging long-term consequences. PE sometimes can introduce ancillary nickel and dime fees such as technology fees, or accounting fees or negotiate rebates from suppliers tied to franchisees’ purchases. Franchisees tend to see rebate revenue streams as hidden royalties (because these fees are not often fully disclosed) which creates franchisee-franchisor distrust, which in turn leads to breakdowns.

   Often with change in ownership comes a change in leadership. Turnover may cause concern with franchisees, especially turnover of long-term employees who possess high domain-area competency and value both brand history and quality franchisee-franchisor relationships.

   In addition, PE firms often negotiate heavily-leveraged deals. The increased debt load means lower immediate earnings and less reinvestment capital to drive the brand forward.

7. **Franchisee brand complacency.** Franchisees often become reliant on large media spend and no longer invest time building relationships with local institutions and community influencers and thought leaders. This leaves the door open for other competitors to come in and create a large local social platform.

8. **Institutionalized thinking.** Many franchisors have turned over leadership to professional management rather than entrepreneurs, thus losing their entrepreneurial edge. Many in professional management have never owned a business before and may not value the day-to-day contributions franchisees make to the business. They may insulate themselves with middle management and make decisions from the ivory tower without a thorough understanding of the impact of their decisions on franchisees.

9. **False sense of security.** Leadership may be trading off past successes, thinking these translate into future victories.

10. **Large scale franchisee consolidators emerge** and sometimes challenge franchisors' leadership and authority, pushing personal rather than brand agendas and thus creating dissention and division among franchisees and franchisor.

TURNAROUND BRANDS

Any brand that does not successfully navigate each growth stage will eventually become a Turnaround Brand. On a day-to-day, moment-by-moment basis, brands strengthen or weaken with every action, conversation, decision, and allocation of resources.

The fall always starts with a lack of attention to the current reality of the brand. Simply put, the brand bought into false assumptions about who they are and what they possess. Then they made a series of bad decisions and resource allocations based on what they believed posed the greatest opportunities for the brand.

Turnaround Brands can become so in any stage, for many of the reasons we described. These brands almost uniformly follow the same patterns.

1. The franchisor pretends they are better than they are and ignores all evidence to the contrary.
2. The franchisor makes several of the classic mistakes we chronicled in each stage of the FPG Franchise Brand Growth Curve©.
3. Impact from the leadership's poor decisions and missteps don't become apparent for 2-3 years.
4. The franchisor continues down the same path until breakdowns are apparent and can no longer be ignored or denied.
5. The franchisor pivots, but often too late to capitalize on an opportunity or to save the brand.

Many Early Stage and Emerging Growth brands do not survive a turnaround. Some may survive due to the strength of the corporately-owned outlets or territory and a few solidly performing franchisees. Often these chains consolidate and retract to the point where a Turnaround is not possible given the franchisor's limited resources and improbability of attracting financing or other sources of capital. Franchisees suffer and fail at an accelerated rate, defaulting on loans and earning a black mark from creditors, making it harder for new and existing franchisees to purchase underperforming units or territories.

Because the franchisor diversifies its revenue across a base of multiple franchisees, some franchisee failure, while unfortunate, is acceptable to the franchisor as the franchisee's share of lost royalty income won't materially impact the franchisor's bottom line. Too often the franchisor pivots too late to help struggling and failing franchisees survive. It's often only when franchisee failure becomes an epidemic that franchisors stop blaming franchisees and start looking at the system that recruits, trains, supports, and resources franchisees, and the flaws that lead them into failure.

Unlike Early Stage and Emerging franchise brands, Regional and National brands will have at one time had a track record of success and a customer base large enough to elevate the brand to its larger brand status. Often these brands aren't so far gone that a turnaround isn't possible. They also have the size and potential cash flow to attract PE and other investors who specialize in turnaround brands and recognize the potential upside when the brand resurges. These brands also generally possess many mature franchisees with operational competency and domain experience to create a turnaround. From Turnaround to Resurgent Brand is often a long, arduous, and expensive undertaking of 3-5 years, and often requires more talent and resources than the brand possesses.

Turnaround Brand Best Practices

Brands that successfully engage in an effective 3-5-year turnaround and begin to resurge often have many of the following characteristics in common.

1. **They gather the necessary data** to objectively measure and assess their problems, gaining perspectives from staff, customers, suppliers, lenders, and franchisees.

2. **They correctly identify primary problems that** spun off more downstream problems.

3. **They identify the key areas, brand attributes, strategic relationships, and staff that are working well**, need not change, or are essential parts of a turnaround. These are protected at high cost.

4. **They hire third parties** to help craft a turnaround plan, knowing the same team and perspective that created the downturn is unlikely to create an upturn.

5. **They communicate the plan** and key performance benchmarks to all stakeholders such as staff, suppliers, lenders, shareholders, and franchisees as well as what the chain needs from each stakeholder. They maintain trust in these relationships.

6. **They skillfully execute the plan and create a breakthrough.** The brand resurges.

Turnaround Brand Risk Factors

Regardless of the brand or stage in the FPG Franchise Brand Growth Curve©, turnaround brands often make one or more of the following mistakes, which prolong the turnaround and can kill the brand.

1. **They blame franchisees** for the franchisor's poorly or inconsistently performing business model.

2. **They look for a million-dollar idea** or a Hail Mary pass to rescue the brand instead of going back to basic business fundamentals and creating a new, unique, profitable, and

sustainable niche.

3. **They diversify their product and service offerings,** often out of their sweet spot, creating brand confusion and more operating and supply line problems.

4. **They don't sign key members of the turnaround team to employment contracts**, risking turnover of key staff.

5. **They don't cement support** for their turnaround strategy with franchisees or key strategic suppliers.

6. **They pivot 1-2 years too late,** extending the time a brand languishes in the turnaround stage.

7. **They put pressure on franchisee recruitment to do bad deals** in order to fund new initiatives, perpetuating the negative cycle while pretending to turn it around.

8. **They put on a happy face** and engage in positive thinking to convince franchisees, franchise candidates, suppliers, and themselves that negative trends and operational issues are a speed bump rather than a negative trajectory and offer no strategic change of direction.

9. **Leadership loses priority** and starts investing time and resources in pet projects or urgent pain points instead of masterminding a brand turnaround. Franchisors engage in a never-ending cycle of fix-it now decisions, and brand strategy goes out the window.

10. **Brand ownership becomes too possessive** and fails to sell the brand to a more qualified team that has the knowledge and financial resources to create an effective turnaround.

11. **Brand ownership overestimates the value of their company** based on what they think the business was worth when they appeared to be winning, walking away from PE and other firms with the capital and experience to turn things around.

12. **Fearing a loss of control,** brand ownership would rather possess 100% of a declining, hemorrhaging brand than a minority stake in a high-value resurging brand. Wendy's resisted this impulse when it sold Arby's to Roark Capital in 2011 for $430 million, which included a $130 million cash payout by Roark and assumption of $190 million in debt, according to the Wall Street Journal. Wendy's also kept an 18.5% minority ownership in Arby's, valued then at $30 million. Arby's resurgence made that 18.5% ownership worth $775 million by the end of 2017, according to Stifel Nicolaus analyst Chris O'Cull.

RESURGING BRANDS

Brands upgrade to Resurging Brand status when they are successfully executing a turnaround strategy which re-engages customers, suppliers, and most importantly, franchisees. These once wayward brands are gaining traction through some combination of modernizing, upgrading, reinventing, recapitalizing, top grading leadership, or simply getting back to their original roots.

Resurging Brand Best Practices

1. **They stay the course.** They skillfully execute the strategic plan in a highly disciplined manner without significant deviation.

2. **They regularly communicate** with brand stakeholders and report results against key benchmarks with full transparency. They communicate what is and isn't working well, backed by data. The case for any adjustments or pivots must be supported by best available data.

3. **They celebrate little victories** to keep all stakeholders informed and engaged.

4. **They stay nimble**, quickly adjusting tactics as necessary to hit key benchmarks.

5. **They protect their team.** Leadership rewards their impact players and minimizes key staff turnover.

6. **They show patience.** Leadership knows they didn't become a Turnaround brand overnight and they don't expect an overnight turnaround either. They know it takes time and effort to engage all stakeholders and recreate market forces to restart the flywheel.

Resurging Brand Risk Factors

1. **Franchisees lose confidence** in the turnaround strategy and go into survival mode, stop reinvesting, and start doing their own thing, creating brand confusion.

2. **Franchisee-franchisor relationships become strained.**

3. **Other brands poach Resurging Brand's impact players.** The brand loses their institutional knowledge and skillful execution, possibly halting the brand's resurgence.

4. **Brand leadership deviates from the plan** before the plan is fully implemented.

5. **Brand ownership or shareholders lose confidence** and stop funding initiatives and engage in layoffs and severe cost-cutting measures.

PREPARING FOR INFLECTION POINTS

2-Year Decision-to-Impact Time Lags

Since franchisors don't often experience the impact of their decisions until one or two years after a decision is made, a franchisor risks wasting three of their most valuable resources: time, money, and human capital. Unfortunately, most franchisors are not fully aware that their decisions are accruing significant impacts until those impacts surface as a series of breakdowns.

For example, a high-flying Emerging franchisor may have doubled or tripled their recruiting results from the previous one or two years. On the surface, this seems like wonderful news, but franchise sales growth can be a problem if it outstrips the organization's capacity to provide the same level of training, care, and support previous franchisees counted on. However, this problem won't become obvious until the new franchisees have been open more than a year and many are underperforming expectations. In the meantime, the chain continues to aggressively recruit franchisees, ensuring even greater organizational strain and weaker than anticipated franchisee results.

During that 1- to 2-year period of rapid franchise sales growth, the franchisor falsely assumes they are winning, but has actually been planting landmines with each successive franchise agreement. Once more than 20% of franchisees are unsatisfied, word-of-mouth will halt new agreements. The franchisor will stop attracting new franchisees and will need to invest heavily to rebuild results — and trust — among existing franchisees. They become the next Turnaround Brand, losing 3-5 years of potential growth in the process.

3-Year Planning Horizons

Because each stage is identifiable and predictable, and each stage dictates the appropriate strategy, franchisors should always be planning for the next stage while implementing the appropriate tactics for the existing stage.

Franchisors who are not currently working from a 3-year planning horizon will often pivot too late, at the bare minimum missing growth opportunities and slowing momentum, but often sending the chain into decline and Turnaround status because they have failed to anticipate the predictable needs and breakdowns of their brand.

Educated franchisors don't wait for brand failures. They ask questions such as, "We have proven we can onboard 10 franchisees per year. Over the next two years, what will it take to successfully onboard 40?" Then they build the new system and organization to support anticipated growth.

THE FPG FRANCHISE FLYWHEEL©

As brands successfully graduate from one stage to the next or engage in an effective turnaround, the brand creates its own momentum, which FPG calls "The Franchise Flywheel Effect."

Momentum propels the brand eventually to a point where the brand appears to have its own head of steam beyond what the franchisor's leadership team creates on their own.

This brand synergy, the very life force of the brand, can never be understood simply by examining its parts.

FPG has found that franchisor leadership often tries to identify and solve their problems or drive results through reductionism. They break the franchisor and franchisee model and brand down into its basic individual silos, departments, and components. Then they try to get results by fixing individual components or pushing individual departments. This approach assumes the brand is nothing more than the sum total of its individual parts. Anyone who has ever been affiliated with an iconic brand or a brand which has hit a tipping point knows that when franchising is done right, there is a synergy which lifts and accelerates the brand. **A brand's total value is larger and different than the sum of its parts.**

For instance, a franchisor may be experiencing franchisee-franchisor relationship issues, creating negative validation and killing franchisee recruitment results. The franchisor responds not by identifying and resolving these sources of conflict, but by creating a list of good validators versus bad validators. Then they direct recruiters to steer franchise candidates to good validators, as if the problem is now fixed and franchisee recruitment results will self-correct.

What do you think is the franchise candidate demand for a franchisor who ignores franchisee-franchisor relationship problems, accepts franchisee dissatisfaction as normal, has no corrective tactics in place, and responds by trying to trick candidates into believing overall franchisee satisfaction is better than it really is? Is this a strategy for long-term sustainability or a path toward an epic organizational breakdown? What is the franchise candidate demand for a franchise that is speeding gleefully towards a cliff?

In FPG's experience, franchise brands seem to follow the tenets of Gestalt psychologist Kurt Koffka, who said, "**The whole is different (or more) than the sum of its parts."** This means when you try to reduce a whole system (in this case, the brand) into what appears to be its separate and individual components, **you risk misunderstanding the dynamics of the entire system, which in this case means the entire franchise ecosystem and brand as a whole**.

It's like trying to understand the cosmos by studying atoms.

In many ways, franchise brands are irreducibly complex. The brand components work together to create a sort of combustible rocket fuel that propels brands forward or, conversely, torches them where they stand. There is a synergistic positive or negative effect in franchising that happens when the brand's drivers are either working or breaking, creating either positive or negative brand momentum.

Brand Momentum Defined

A successful franchise brand perfects an organic ecosystem of value FPG calls The Brand Value Chain©. The value chain looks something like this:

1. The franchisor exists for the sole purpose of adding more measurable and perceived value to franchisees in the form of business systems, marketing, resources, brand equity, and bottom-line results than it extracts from them in royalties and other fees.

2. Franchisees exist for the sole purpose of delivering more measurable and perceived value to customers in the form of products, services, and overall customer experience than it charges in price.

When each party skillfully executes its role and honors its commitments to the other, the brand builds positive momentum.

If all brand stakeholders buy into the value-added premise, the organization will soon create a culture of brand stakeholder value alignment. Once this culture is adopted, these beliefs and behaviors become the organization's normal, and anyone or anything that threatens the norms gets confronted and ostracized from the brand. Put another way, the brand polices itself, protecting itself from both internal and external threats.

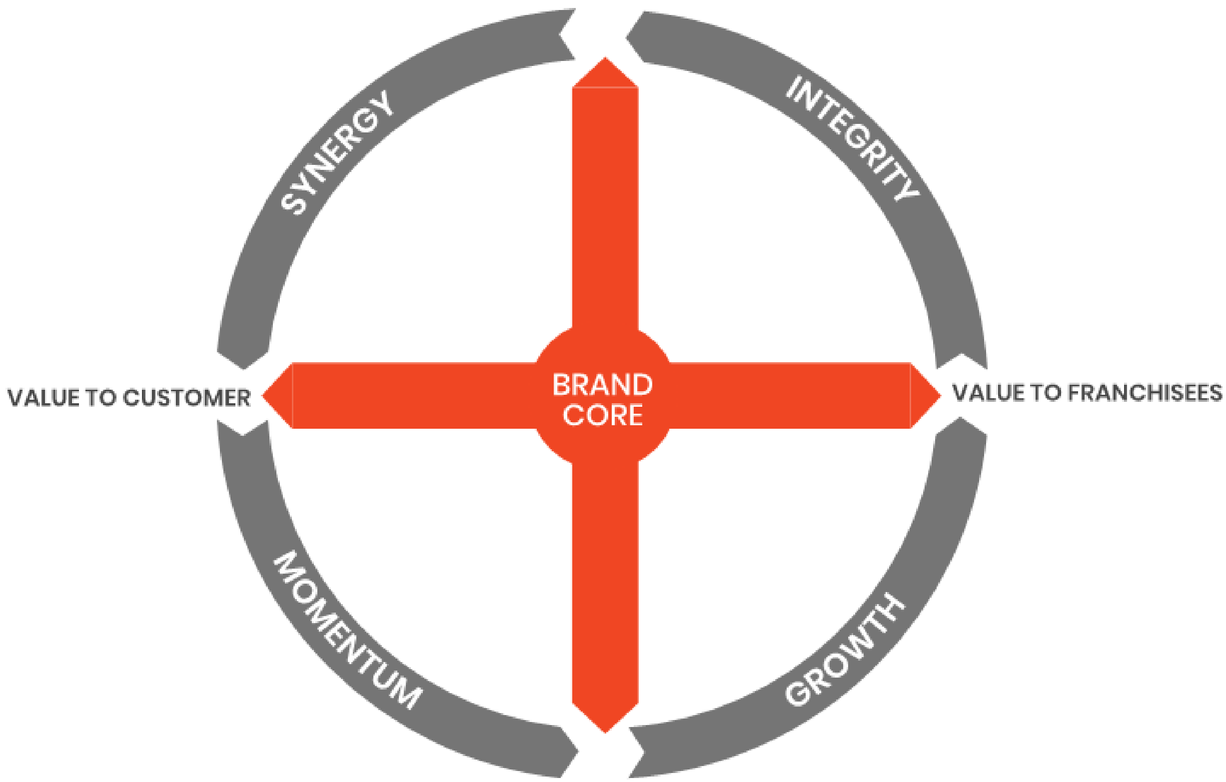
FPG Franchise Brand Value Chain©

According to the FPG Franchise Brand Value Chain©, brand constituents move the brand forward through these continuing learning process:

- Studying and observing how each brand constituent and stakeholder defines and delivers value.
- Determining how each constituents' attitudes, culture, and organizational behavior impacts the whole.
- Applying organizational learning and insights to improve constituents' processes, skills, and performance.

When the brand puts parochial interests aside and focuses on operational excellence and delivering customer value rather than controlling (or avoiding being controlled by) other brand constituents, the brand creates a virtuous cycle of continual improvement and positive forward momentum FPG calls the FPG Franchising Flywheel©.

The Flywheel at a glance



This body of work is designed to help franchisors identify and do what it takes to create their own workable and perpetual Franchise Brand Value Chain and Flywheel.

Franchise brands seem to follow Newton's First Law of Motion, creating and sustaining either a virtuous cycle (flywheel) or vicious cycle. Bodies (or brands) in motion will continue in their current trajectory (growth or decline) unless acted upon by a disruptive force. Business seems to also abide by similar laws. For instance, authors Clayton M. Christensen and Joseph Bower determined how category and industry disruptions are often caused by strong external forces rather than the current market leader, like Uber and Lyft disrupted the taxi industry.
In his book *How the Mighty Fall*, author Jim Collins studied how a brand's vicious cycles are often caused as a byproduct of the leadership's internal blind spots and hubris. So, major disruptive forces can also germinate from inside the brand.

Collins saw a linear progression of common mistakes successful company leadership makes after they first achieved a virtuous cycle and flywheel effect. For greater readability, FPG altered the names of some of the stages but kept their meaning intact:

Stage 1: Excessive pride
Stage 2: Undisciplined and irresponsible pursuit of more
Stage 3: Denial of risk
Stage 4: Decline in results
Stage 5: Brand irrelevance or Turnaround

The first three stages start as leadership character flaws which manifest as “the truth,” (“We really ARE smartest guys in the room!”). These attitudes eventually become ingrained in the company’s leadership culture and management philosophy, which in turn impact decision-making, strategy, goal-setting, risk tolerance, and resource allocation. This creates strategic overreaching (i.e., new product or service extensions, brand acquisitions, taking on ill-advised debt) and tactical misfires, ignoring information, ultimately translating into an unexpected decline in results, transforming a virtuous cycle into a vicious cycle. The brand will continue its vicious cycle decline (or negative flywheel effect) until it develops the organizational backbone to acknowledge and execute a turnaround.

In franchise brands, these breakdowns occur at predictable inflection points along the franchise brand growth cycle FPG detailed elsewhere in this work.

High-growth chains with well-executed franchise models outpace themselves year after year with seemingly less energy and effort than it took to produce results from the previous year. It's FPG's experience that brands with forward momentum (Flywheel effect) keep their momentum until something disrupts it.

Because it is our assertion the entire brand ecosystem moves the flywheel, the brand's disruptive forces can include leadership, franchisees, and suppliers — not just external competitive forces. Once the franchisor's flywheel slows or stops, it becomes a Turnaround Brand.

Any unidentified and uncorrected breaks in the value chain will eventually create more stress fractures, eventually leading to multiple failures and a downward spiral. The longer the spiral, the more difficult it is to course correct and move the brand into a Resurgent stage.

Marketplace Movers

The primary brand accelerator can be summarized in two words: added value. Franchisors must add more perceived value to franchisees in customer perceived brand value, marketing, tools, tactics, brand position, product/service advantage, best practices, training, and support than it extracts from them in royalties or the brand runs a high risk of slipping into a turnaround stage. Customers must almost uniformly believe they receive more value in their commercial dealings with franchisees than franchisees charge, or the brand will be the next turnaround.

Importantly, the franchisor's leadership has no say about how franchisees define and measure value. Nor do franchises have any say in whether or not customers get their value.

To maximize the value creation within their areas of responsibility as depicted on FPG's Flywheel, franchisors must collaborate and communicate with their franchisees on meaningful levels. The franchisor's perceived value cannot be sold, mandated, manipulated, or forcefully jammed down within the organization or outside to the franchisee level. How franchisees measure value and whether the franchisor routinely delivers it resides entirely within the minds, hearts, and business checking accounts of their franchisee community.

In turn, franchisees also must be keenly aware of how their customers measure value. Franchisees do not get to say whether or not value was added and delivered on the consumer level.

When each party masterfully and habitually adds more value to its constituency than it extracts in fees, the flywheel turns, creating forward momentum. And like any object with forward momentum, it takes less energy and resources to maintain forward motion than it does to create it.

When the brand constituents systematize and commit to the habit of delivering added value, the flywheel will continue turning, creating exponential growth with greater ease and fewer spent resources than in the past.

Once the flywheel is turning, the momentum seems to create its own momentum. *This does not mean the franchisor won and is now on a straight path to iconic brand status.* This only means the brand is winning relative to where they are in the life cycle (Early Stage, Emerging, Regional, National, or Resurgent). Eventually, unless adjustments are made, the winning formula relative to the brand's growth stage plays itself out and the flywheel stops.

It is the brand leadership's job to look three years out at all times, positioning the brand to succeed in the next stage before the brand has successfully completed the current stage.

Otherwise, the flywheel will slow, and if not attended to, the flywheel spins in the wrong direction, becoming the negative spiral we addressed earlier.

It's the brand's leadership's responsibility to understand where the franchisor currently sits in its life cycle. Then they must accurately appraise the brand's readiness to succeed in the next stage of the life cycle. That means knowing in advance what is expected of the brand and the organization, correctly pegging what the brand has and what it is missing, and identifying which people, processes, and systems are scalable and who and what will predictably break down. Then leadership has to train, develop, and resource the entire brand (franchisees, franchisor employees, and key suppliers) to adequately prepare them for what is coming in the next 1-3 years as the brand moves into its next inflection point.

How Do You Know the Flywheel is Slowing?

When the flywheel is spinning, it feels like the brand appears to be on one continuous cycle of forward momentum.

When the flywheel is slowing and a negative spiral is approaching or already on hand, the brand feels like a never-ending series of one-off problems and catch-up days. Strategy goes out the window and everyone gets preoccupied daily with their version of emergencies or breakdowns. Unlike the flywheel -- which occurs to leadership as one large continuous cycle with its own head of steam -- in a negative spiral, leadership feels like a plate-spinning circus act. Leadership exhausts itself running helter-skelter from plate to plate, not with the goal of maximizing available opportunity or implementing brand strategy, but with the frenetic and frantic goal of not letting the brand fall apart.

15 Attributes of Market Leading Brands

While franchising represents almost $1 trillion in sales generated by almost 800,000 outlets in nearly 80 different industries, the brand success formula is amazingly consistent. The flywheel moves similarly for most brands.

FPG finds that market leaders experiencing a cycle of positive forward momentum have the following attributes in common.

1. Visionary and discerning leadership
2. Open channels of communication for employees, franchisees, customers, and suppliers.
3. Solid unit-level economics which deliver franchisees consistent and expected returns
4. Workable and trusting franchisee-franchisor relationships
5. A business model that is unique, profitable, sustainable, and occupies a defensible position in the marketplace
6. Customers who place a high value on the franchisees' product and service offerings
7. Franchisees who place a high value on what the franchisor offers
8. Mastery-level understanding of their customer-facing model
9. Mastery-level understanding of the business of franchising, namely recruiting, training, developing, supporting, resourcing, and leading highly skilled franchisees
10. A solid strategic plan for moving the brand to the next stage of the franchise life cycle
11. Discipline, capital, skills, and experience necessary to execute their strategic plan
12. A franchisor belief system which states franchisors exist to add more value to franchisees than franchisees pay in royalties
13. A franchisee belief system that they exist to add more value to their customers than they extract in price
14. A steady stream of satisfied customers who value the brand promise, positioning, and products and services
15. Total brand buy-in from the franchisor, franchisees, suppliers, and customers

If a brand is missing more than one of these attributes, the brand is at risk of becoming mired in a turnaround and actions need to be taken.

Franchisor's often fear, ignore, devalue, or misinterpret the Flywheel because it shows that the brand is bigger than the franchisor, with a large portion of the brand's potential and added value lying outside the franchisor's control. It shows franchisors that regardless of the language in their franchise agreement, worthy brands are truly community property. When done right, all brand constituents, including customers, experience some level of brand ownership. Customers step up as if they were duly appointed brand ambassadors to their communities and networks, introducing others to "my brand," "my place," or "my people."

The simple formula of adding more value than received in fees creates an unwritten noble obligation among customers, suppliers, franchisees, and employees to return the favor and reciprocate in some way. They give back some version of money, time, and energy to the brand that added value to them, ensuring it survives and thrives.

The Flywheel Paradox

In the final analysis, the Franchising Flywheel is a paradox. **Because everyone gives more than they get, in the end everyone gets more than they give.** What they ultimately receive in the end is often abundantly more than the constituents predicted.

For instance, the spiritual values of the leadership and store managers of Chick-fil-A shape their business model. “The Chick-fil-A culture and service tradition in our restaurants is to treat every person with honor, dignity and respect and to serve great food with genuine hospitality," CEO Dan Cathy told the *Atlanta Journal-Constitution* in 2014. The brand is famously closed on Sundays so employees can honor the Sabbath. Despite restaurants operating just six days a week, customers have rewarded the brand with the highest average volume sales in the QSR segment.

Back in 2012, an advocacy group planned a nationwide brand protest at Chick-fil-A restaurants across the United States. Media commentator Mike Huckabee, a longtime customer and brand advocate, decided to make an effort to protect the brand by declaring Aug. 1, 2012, Chick-fil-A Appreciation Day and posted it on social media. Customers turned out in record levels. Drive-thrus in some locations were a mile long with more than 2-hour wait times. Police had to direct traffic in many locales because of the number of cars blocking the ingress. After Chick-fil-A tallied their end-of-day sales, they announced the single greatest revenue day in the history of their company.

For a moment, leave politics and religion aside. Isn’t it interesting that the most successful single-day promotion in the history of QSR was started by a customer and had nothing to do with the parent company, its marketing department, or its franchisees or licensees? Arguably, the most successful promotion in the history of food service can be sourced back to the Franchise Flywheel, created by the brand ecosystem in response to a perceived threat.

Conventional franchising (the way most brands currently execute the franchising model) appears to ensure the Flywheel never spins under its own power. Franchisors discuss the brand in terms of “my brand, my system, my customers, and my suppliers,” but it’s the franchisors’ possessiveness and need for control that is one of the primary reasons most franchise brands never flourish. Franchise brands are launched inside an ideology or paradigm that virtually ensures the brand eventually engages in the type of self-limitation, self-sabotage, and parochial possessiveness that creates headwinds and a drag on the brand.

When brand constituents experience a brand value chain defined by giving more than you take, the recipient is prone to giving back to the giver and brand in meaningful ways. It’s this elegant reflex reaction to give back that moves the Flywheel, producing results and outcomes the brand stakeholders and constituents could never have predicted.

Once the Flywheel moves, brands no longer need to push to create momentum. On the contrary, many find themselves in the position of not being able to keep up with increased demand.

The Flywheel will keep spinning and the brand will flourish under its own power, growing exponentially in both unit count and unit-level profitability, until something disrupts it. Eventually, habitual winning becomes ingrained in the corporate culture.

ESTABLISHING A WINNING CULTURE

How one individual franchisor employee views franchisees or how an individual franchisee views the franchisor speaks more about the individuals than the brand. However, the prevailing common collective beliefs and attitudes about franchisees and the franchisor determines culture. Once culture is determined, it is difficult to change.

The core elements which appear to drive brand cultural beliefs are as follows:

- **Unit-level economics**. Are franchisees' financial returns meeting their expectations? If not, how are the franchisor and franchisees working together to define and address the issues?

- **Franchisee training, support, and resources.** What is the quality and effectiveness of the franchisor's training, support, and performance management systems? Would franchisees say the value of the tools and support they receive is greater than or equal to the royalty dollars invested? How are the franchisor and franchisees working together to enhance brand value and drive franchisees' profitability?

- **The trust level and workability of the franchisee-franchisor relationships.** Do franchisees, employees, and franchisor leadership trust each other and work towards crafting mutually profitable campaigns, offers, and solutions? Do franchisees feel they are heard and understood? Does information routinely flow up and down the organization or just funnel down from on high? Would franchisees say they are informed about issues important to them? Would they say they feel like an integral part of a team or more like the low man on the totem pole?

How franchisees and the franchisor answer these questions speaks volumes about the culture of the franchise organization. Strong financial returns go a long way to satisfy franchisees' concerns, but ROI alone is not a substitute for trusting franchisee-franchisor relationships, mutual transparency, and collaborative problem-solving. Enduring franchise brands offer franchisees both.

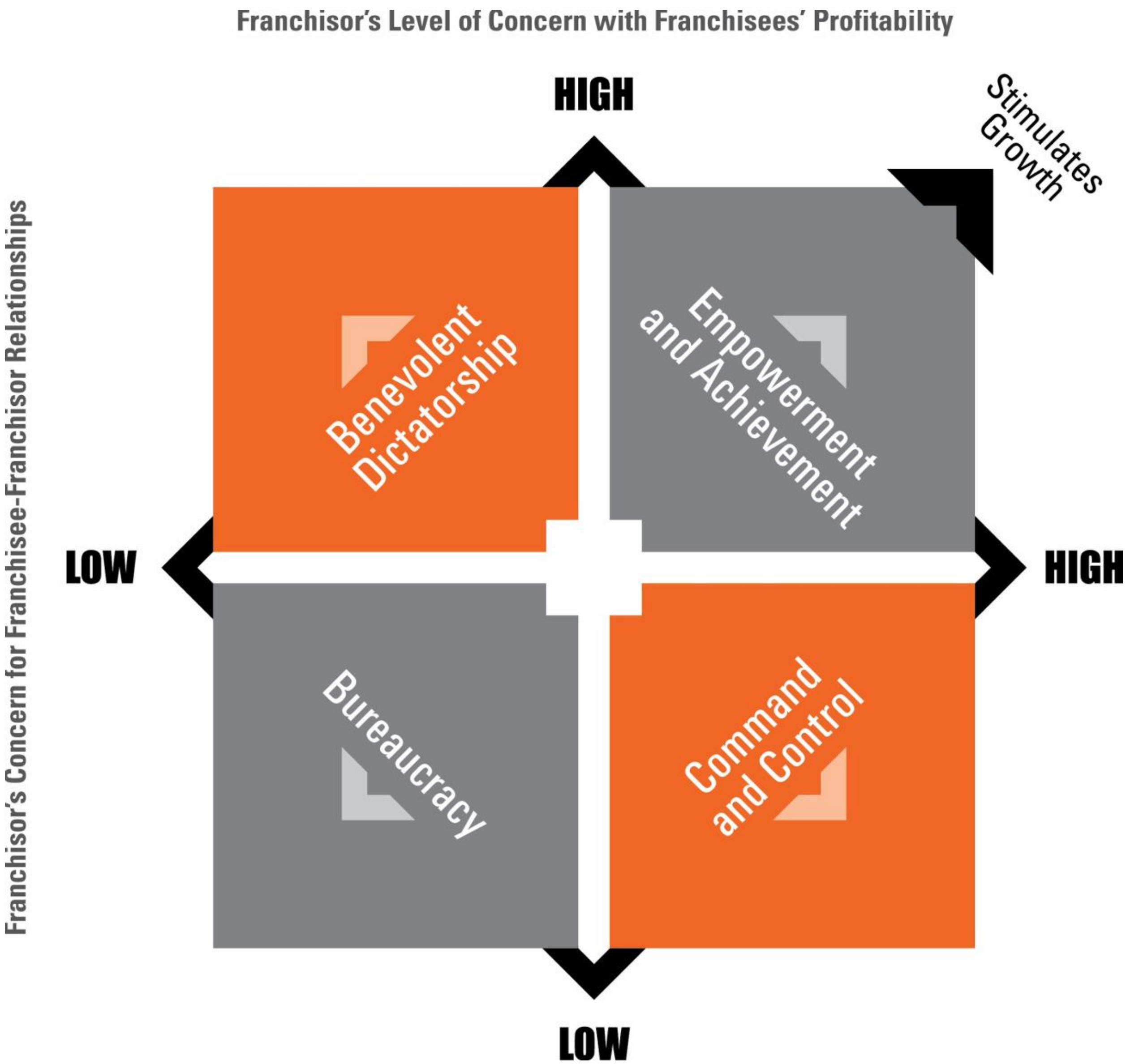
Franchisors with a collaborative, franchisee-friendly corporate cultures will attract more sophisticated and talented franchise candidates than more heavy-handed franchisors who resort to threats, punishment, and coercive command-and-control techniques to try to keep franchisees in line.

Types of Franchising Cultures

Dr. Jay Hall, Ph.D., spent a lifetime studying the impact of corporate culture on individual performance. Dr. Hall has identified four prevailing corporate cultures, which FPG has licensed and modified to reflect what occurs in franchising.

Each culture is marked by two distinguishing characteristics: the franchisor's level of concern for franchisees' results, and the concern for franchisee-franchisor relationships. At any time, any company can exhibit traits from any one of these cultures. However, over the long haul, franchise organizations tend to exhibit a dominant pattern of beliefs and behaviors.

We will look at these cultures in a progression starting with the least effective and progressing towards the most effective.



The Bureaucracy

Bureaucracies are highly legalistic, highly layered companies where the lower you go in an organization, the less decision-making responsibility and authority an employee of the franchisor has. The organization seemingly exists to maintain the status quo, avoid accepting personal responsibility, and elude being held accountable for producing results. When a franchisee is faced with a unique challenge or makes a special request, the knee-jerk reaction throughout the layers of management is “No,” coupled with “We don’t do it that way,” regardless of whether or not what the organization is currently doing actually works or remains in the franchisees’ or customers’ best interests. Change is met with stiff resistance, and individual initiative is frowned upon by management. Employees and franchisees are expected to follow the rules, do what is expected, and resist original thinking. Policies and procedures are set to control employees to ensure compliance, not to drive results.

Impact on Franchisor’s Employees and Franchisees

Ponder the type of corporate employees and leadership which would survive in this franchise culture in the long-term. Those franchisor employees who are dedicated, results-oriented, efficient, entrepreneurial, visionary, big-picture thinkers, or out to make their mark in the world would be ostracized, and then quit or be fired. Only those who simply want to earn a steady paycheck while hiding out and avoiding personal responsibility would want to stick around for the long haul in this environment. Think about the type of person whose goal in life is to secure a good job with the Post Office or Motor Vehicle Department. Are you picturing a real go-getter and risk taker?

Because bureaucracies value sameness and security over performance and efficiency, they remain a breeding ground for underperformance.

Now think about the quality of the interactions between the bureaucratic franchisor support staff and the franchisees under their charge. Would these conversations and communications pertain more to tactics and strategies about how to drive franchisees’ sales and results, or would the conversations tend more toward what franchisees must do to continually stay in compliance?

Once, a bureaucratic retail chain forced its franchisees to adopt a management information system at a cost of tens of thousands of dollars per location to its franchisees. Franchisees who beta-tested the system reported that the system had bugs, routinely lost customer transactions (meaning revenue to the business) and was not ready for a national roll-out. Brand leadership ignored the franchisees’ warnings and forced franchisees at threat of default to adopt the new system. It was more important to the franchisor that all franchisees operate from one flawed standard system than several working systems. One year later, their newly adopted system still corrupted data and transaction information, making many reporting functions meaningless.

Impact on Results

Franchising works because it makes businesses more decentralized, flexible, and nimble by completely empowering and creating ownership to those closest to the customer. Bureaucracies create the opposite effect. Therefore, bureaucratic franchisors have little staying power in today's competitive commercial marketplace. This is why most surviving bureaucracies exist in the public sector where people have no other alternatives with regard to corporate cultures.

Benevolent Dictatorship

Benevolent Dictatorships are typically informal, folksy, low-stress companies where much attention is paid to making people feel good. Feeling good, being appreciated, and loyalty to leadership are more important than bottom-line results. This culture is commonly found in small, privately-held franchisors where the founder or owner places friends and family in key management positions, not because they are the most qualified people for their jobs, but because they can be trusted to do the owner's bidding without pushback. Unless an employee possesses the right last name, marries into the family, or plays golf with the owner, often there is little room for advancement. The owner isn't really out to build a powerhouse brand, but a little brand fiefdom where the brand ownership, employees, friends, and franchisees are taken care of. If you were a franchise candidate attending a Discovery Day, at first glance this culture seems informal, unassuming, and perhaps attractive to a new entrepreneur.

However, often the counterproductive underlying beliefs of leadership that permeates within the franchisor's company is, "My brand, my system, my customer," and "Franchisees are like employees and need to do what we say." Ultimately, this will lead to tension, fractured trust, and breakdowns in the workability of the franchise-franchisor relationship. While personal franchisee relationships are held up as important to the brand, these relationships are skewed as they aren't marked by the typical characteristics of an adult relationship. These relationships more resemble the parent-dependent child relationship than an interdependent, synergistic commercial relationship.

Until franchisors embrace the idea franchisees are highly capable individuals who need the tools, resources, and freedom to build strong brand value and offer the brand a leverageable competitive advantage in the marketplace, regardless of current franchise sales success, the brand will quickly plateau and then decline. Ultimately, these brands devolve into situations where the brand inherits are the risks of being a franchise with none of the corresponding rewards. These beliefs are seeds which sprout the next turnaround brand.

Impact on Franchisor's Employees and Franchisees

Because the brand leadership demonstrates little faith in the capabilities of managers, staff, and franchisees, power, authority, and decision making are concentrated at the top. The brand ownership become the puppet masters, pulling the strings and making employees and franchisees dance to a tune only they hear.

As in bureaucracies, information mostly flows downhill, instead of up and down the organization. Brand leadership makes strategic decisions from the ivory tower and leaves middle management the role of town squire to announce decisions to the lowly franchisee citizens of the band fiefdom.

Think of what happens to talented and upwardly mobile employees or talented franchisees of this kind of organization. Brand leadership calls 100% of the shots without feedback or meaningful discussion. Those high caliber employees of the franchisor and franchisees who know their value and wish to collaborate in the decision-making process and see their ideas implemented won't last. Only those willing to consistently do the bidding of the Benevolent Dictatorship will remain, weakening the brand.

Highly capable franchisor employees and franchisees will find and join a culture which values performance, results, and initiative.

Impact on Results

Now think about the quality of training and ongoing support these surviving low-skilled department heads and employees can offer franchisees. Will it be enough for results and action-oriented franchisees to win or will they find it necessary to go outside the organization for tools and support? If these franchisees complain about either the quality of support or not being invited to participate in decisions impacting them, their comments aren't often heard in a commercial context. The franchisor will often respond with, "Don't these unappreciative franchisees know how hard we work? Don't they realize we are just trying to help them?" In a Benevolent Dictatorship, the franchisor's intentions and franchisees' appreciation are more important to the franchisor than franchisees' performance and results.

A Benevolent Dictator, CEO and founder of a multi-brand franchisor, does not give officers and department heads annual operating budgets. He made decisions on how his money is spent on a case-by-case basis. While he executed his own financial plan, he seldom shared what that was with others, keeping department heads guessing. In addition, he regularly moved employees between brands without consulting with brand leadership or the individuals being redeployed about what they wanted and needed. The CEO believed he knew best, and his employees and franchisees would understand over time. The different brands eventually shuttered units and franchisees failed to renew their agreements at renewal time. The franchisor's brands now cease to exist or just linger, being managed by the franchisor's skeleton crews.

Command and Control

This is one of the most common cultures within franchising. Command and Control companies have strong central authorities where most strategic decisions are made. While power and authority may be more diffused than in the Benevolent Dictatorship culture, it’s still consolidated at the top. While data routinely flows up from franchisees to the corporate office, decisions are more often than not handed down. While franchisors may have advisory committees consisting of franchisees, these committees aren’t decision-making bodies. They exist to advise the decision-makers who are free to accept all, some, or none of the advice. In addition, franchisor leadership isn’t always transparent with information, disclosing only what they deem franchisees need to know. While the franchisor leadership may verbalize such things as “franchisees are partners and stakeholders in the company,” their attitudes, actions, and private conversations tell a different story.

From the get-go, franchisors often design themselves to be this way. For instance, almost every FDD and Franchise Agreement perpetuates this culture. If you were to read your FDD right now, most likely you will see paragraph after paragraph about what franchisees must or must not do along with corresponding punishments should franchisees fail to act accordingly. If you were to then read the franchisor’s obligations, more than likely, you will come across language such as, “Although not required, the franchisor may from time to time at its own discretion choose to (fill in the blank).”

Like the Benevolent Dictatorship, franchisor leadership believes, “My brand, my system, my customer,” and “Franchisees need to do what we say.”

These franchisors let legality and parochial interests interfere with brand strategy.
From a legal standpoint, clearly the franchisor owns the brand. From a legal standpoint, it’s also the franchisor’s responsibility to protect the brand.

But from a branding standpoint, franchisees and franchisors would share responsibility. Look at Apple, Harley-Davidson, and White Castle. These brands have a cult-like following and lives of their own. These companies offer their brands to their respective communities to build relationships on their own terms. In response, customers, and stakeholders make it their responsibility to ensure the brand thrives.

In the past, FPG worked with Snap-on Tools. At the time of our engagement, professional mechanics exponentially preferred Snap-on Tools over their competitor’s tools. To demonstrate the cult-like following of the brand, Snap-on’s Director of Franchising produced photos of men walking around NASCAR races with Snap-on tattoos on their shoulders, backs, and forearms.

Legally, this represents an unauthorized use of the brand’s logo and the company is within its rights to force the customers or franchisees to make appointments with a dermatologist to have them removed. No brand can command or control such brand loyalty and excitement. Such brand loyalty and following unfolds over time, taking a life of its own.

Impact on Franchisor’s Employees and Franchisees

Command and Control cultures are formed from several limiting and somewhat dysfunctional beliefs about the nature of franchisees and what makes franchising work.

These self-limiting cultural beliefs often include:

- Franchisees and employees are slackers and are always looking to get away with something. The brand needs to stay on top of them to build the brand right.
- Franchisees' and employees' objectives are less important than the franchisor's objectives. They exist to serve the franchisor's interests and should check self-interest at the door.
- Franchising allows the franchisor to build the brand using the franchisees' money. Franchisees are a necessary evil.
- If you want franchisees and employees to perform, the franchisor should reward the behavior they want and punish the behavior they don't. Leadership implements a carrot-and-stick leadership model.
- Mistakes are bad. Uniformity is good. Systems exist to minimize mistakes and control behavior. Don't think. Just follow the system.

If you are a highly skilled, motivated, upwardly mobile franchise professional, would you want to work here? And if you were already working here, how long would you stay?

If you were a franchise candidate looking to invest in a franchise, would you join? If you were already a franchisee of such a system, would you sell?

Impact on Results

The core values of a Command and Control culture are results, power, and control. Here is the major disconnect Command and Control franchisors create with franchisees. When asked, "Why do you want to start a business?" almost every franchise candidate in existence repeats some version of, "I want more power and control over my life, career, and investments." So, you can clearly see why in this culture, franchisee-franchisor conflicts are inevitable. That's why companies exhibiting a dominant Command and Control culture are so often sued by disgruntled franchisees, or routinely have franchisees banding together to create alliances to beef up their numbers to take a stand against the company. They end up fighting each other for control (or to avoid being controlled) rather than fighting the competition for increased market share. Such brands burden themselves with the risks of franchising while at the same time negating the value.

Once, the Command and Control founder of a food concept walked into a new franchisee's recently opened place of business unannounced. It was a peak time and the new franchisee was struggling to handle the customer volume. The founder became angry and started barking out commands to the franchisee's employees, ordering them around. When the franchisee objected to what she believed to be inappropriate behavior, she was told, "We are the parent company and franchisees have to do what they are told." When retelling this story, the franchisee said, "I already have parents and don't need more. I wish someone told me I was going to be their child before they took my money." How motivated was the franchisee after the encounter? What is the predictable impact of this encounter on her brand experience? When a new franchise candidate is looking to invest in a franchise and reaches out to this owner, what will the potential franchisee most likely hear?

Empowerment and Achievement

The Empowerment and Achievement culture creates the most fertile ground for cultivating an iconic national brand by providing an inviting environment which attracts and retains highly skilled and self-directed franchise candidates and franchisor executive and employees.

Brand leadership see their jobs as facilitators. They routinely interact with the top-producing employees and franchisee thought-leaders making sure they have what they need to win. They identify and eliminate potential bottlenecks or barriers to forward momentum. They are not egocentric. They give the necessary power, authority, and resources to those responsible for creating results. They are transparent with information. They are clear about the individual needs of employees and franchisees and work to align their individual goals with business objectives, so everyone wins.

The support team of one 500-unit franchisor sought to understand who their franchisees were as individuals and what drives them. The franchisor's support team used the franchisees' stated objectives as a context for their support recommendations. The support team showed franchisees how they can move closer to achieving their goals by implementing the franchisor's recommendations. The franchisor's support team is trained in how to identify franchisees' communication styles and feed them information consistent with how these franchisees absorb and process information, minimizing communication breakdowns. The Support Team is trained in adult learning principles, coaching principles, consulting best practices, negotiation, and conflict resolution techniques. As a result of the outstanding training, consulting, and coaching given by the Support Team, the brand has grown to over 500 locations in a highly competitive QSR segment.

Impact on Employees and Franchisees

Empowerment and Achievement cultures attract and retain top franchisor executives and employees and franchisee talent. Leaders, employees, and franchisees thrive personally and professionally within the teamwork-driven, results-oriented culture, unlocking the best of who they are and actualizing the most of what they can achieve. The franchisor and franchisees experience being valued and respected. Employees of the franchisor are rewarded consistent with their performance and promoted based on merit. Instead of consolidating power and authority at the top, the franchisor's leadership manage a bottom up company, dedicating time, money, and energy empowering franchisees to spend resources, make decisions, and ultimately produce outstanding results.

Franchisees and the franchisor enjoy rock-solid relationships. Both seem to understand that each needs to make a healthy return on their time and money and neither can perform at high levels unless all their companies are healthy and profitable. When faced with a problem, they engage in win-win solution rather than win-lose fighting.

Impact on Results

Brand leadership uses their executives, employees, and franchisees as their big idea farm, implementing the best ideas from their trusted people closest to the customer. Franchisees buy into the franchisors brand vision and make it their personal mission to deliver the brand promise. The brand leverages franchisees' entrepreneurship and skilled execution into a key strategic advantage in the marketplace. Rather than battling each other for control, franchisees and the franchisor collaborate on executing and systematizing the best ways to capture market share and deliver the brand promise to their customers.

These franchisors don't look at systems as a method to control behavior and minimize mistakes. They realize every major breakthrough by definition occurs when an employee or franchisee isn't following the system. Systems exist to replicate outstanding results, not to hinder innovation and destroy initiative. The franchisor and franchisees foster a learning and continual improvement culture, constantly refining and innovating.

As a result, customers understand the brand value. Some become local brand ambassadors. Others become cult-like followers.

Investors take notice, and franchise interest skyrockets.

The Franchise Flywheel turbocharges, and the brand hits a tipping point. Winning becomes an organizational habit. Franchisees produce greater results with less time, money, and energy invested.

Eventually, private equity discovers the brand and assigns a premium enterprise value to reflect the brand's sound business model and highly predictable royalty streams driven by happy and profitable franchisees.

Evolution of Corporate Culture

Unless the franchisor is already a significant chain that enters franchising later in their life cycle, many franchisors enter Early Stage and Emerging Growth as Benevolent Dictatorships. These companies are generally privately held and tightly controlled where leaders wear multiple hats and perform functions they were never adequately trained for.

During Early and Emerging Growth stages, often franchisees are treated like family. Leaders develop close interpersonal relationships. The brand generally maintains an informal family-style relationship among its stakeholders until it becomes no longer workable. As the brand expands and the organization begins to hire middle management and domain area experts like marketing, training, real estate, and field support, those franchisees who invested during Early and Emerging Growth stages no longer have immediate access to the C-suite.

As the business grows, the franchisor evolves from informal management and leadership to a formal organizational structure with clear job descriptions and clear personal, departmental, and organizational objectives. The franchisees will experience a shift to a more professionally-run organization with new professional boundaries. Sometimes franchisees and/or the founder resist this shift. Many entrepreneurs initially start businesses as a rejection of the traditional corporate structure, and now the very organization they joined is beginning to feel like what they once rejected. This is a recipe for staunch cultural and organizational resistance from both brand ownership and franchisees.

Smart and adaptable brands anticipate this shift and manage franchisees' and stakeholder expectations upfront. Franchisees join because they want to participate in a successful brand. Early Stage franchisees in particular desire a meaningful role in a successful brands' history, but they may not know in advance what that looks like. Smart franchisors spend extra time communicating to their Early Stage and Emerging Stage franchisees exactly what to expect over time and how growth will change the franchisee-franchisor relationship. By securing franchisees support, the franchisor has the freedom to naturally grow and evolve without staunch resistance.

If growth and relationships are being managed properly, the chain will evolve into an Empowerment and Achievement culture. Unfortunately, these culture shifts are often mismanaged. Often, franchisors' leadership react to franchisees' pushback by creating a legalistic and authoritarian Command and Control structure.

As chains grow, the increasing demands of the roles outstrip many of the franchisor's team members' ability to keep pace. Where on-the-job training may have been enough when growth was a trickle, as the chain enters exponential growth, the franchisor should be hiring experienced high-capacity executives whose leadership capacity exceeds the franchisor's rate of growth. But that's often not what happens.

Benevolent Dictators value loyalty. Sometimes they are loyal to a fault. They give their team many opportunities to step up and perform, seemingly blind that the job demands more than team possesses the capacity to deliver. Meanwhile the system continues to break down and eventually franchisee-franchisor relationships fracture.

Because franchisees stop getting the attention they are used to, they start doing their own thing, often inconsistent with brand identity and brand standards, creating brand disconnects and confusion in the mind of the customer.

Poorly managed growth creates a brand experience of spinning out of control. The franchisor spends all of their day in a break-fix mentality, resolving one-off conflicts and issues. Work stops being fun. Strategic plans sit on a shelf while the organization spends another day fighting fires.

The franchisor knows their team is spread thin. Sometimes valued employees buckle under the pressure and quit, and the chain loses precious brand expertise at the time they need it most. The franchisor begins to hire out of desperate need, onboarding managers and leaders from other chains. These new hires embed processes, procedures, and organizational behaviors from past chains. The franchisor begins to look and operate like a patchwork quilt of stop-gap solutions imported from other brands. Because new hires are expected to build the plane while they are flying it, they often don't have the time to stop and assess or align their approach with brand identity and brand values.

Eventually, franchisor leadership gets fed up with their sense of loss of control and franchisee-franchisor friction and they start tightening the screws on the franchisee community. By doing so, they usher in a new era of Command and Control.

This culture does not sit well with franchisees. Franchising works through collaboration, influence, and alignment of franchisee and franchisor interests. Entrepreneurs by their very nature resist strong-arm tactics. The more authoritarian franchisors behave, the more they will be met with stiff resistance from franchisees.

The franchise agreement is written so franchisors have all the cards. Franchisees know they can't win a direct assault, so they often engage in hit-and-run or passive-aggressive behavior. They spread negative validation, blowing up the franchisor's already declining pipeline. They stop attending national conferences. They decline assistance from field operations, or worse, enroll field ops teams in their issues, turning them against the franchisor.

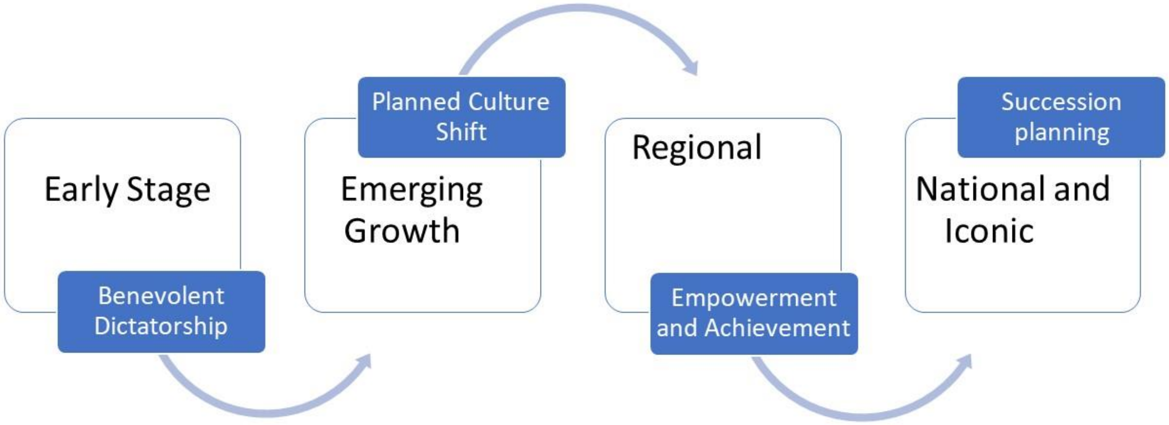
Brand strategy goes out the window. The brand enters a negative, self-perpetuating downward spiral. The franchisor becomes the next turnaround brand.

How Iconic Franchise Brands Protect Culture

Iconic brands don't hire staff to just to fill chairs because they are stretched too thin. Instead, they have accurately assessed who are the organization's high potentials and either hired outside mentors or budgeted time and resources to train them up in advance for success in their next role.

They also know which positions need to be staffed by bringing in talent from the outside. To avoid hiring from desperate need and requiring new employees to hit the ground sprinting, franchisors invest in the proper human capital 6 to 12 months in advance, allowing the brand to organically grow into the franchisor's increased capacity. This allows the brand to educate the new hires on how to work within the franchisor's Empowerment and Achievement culture, minimizing the risk of having new hires import dysfunctional organizational behaviors from previous cultures.

When done right, the culture will experience a maturity process that will look something like this.


Early Stage
Benevolent Dictatorship
Planned Culture Shift
Emerging Growth
Regional
Empowerment and Achievement
Succession planning
National and Iconic

HOW THE MARKET REWARDS ICONIC FRANCHISES

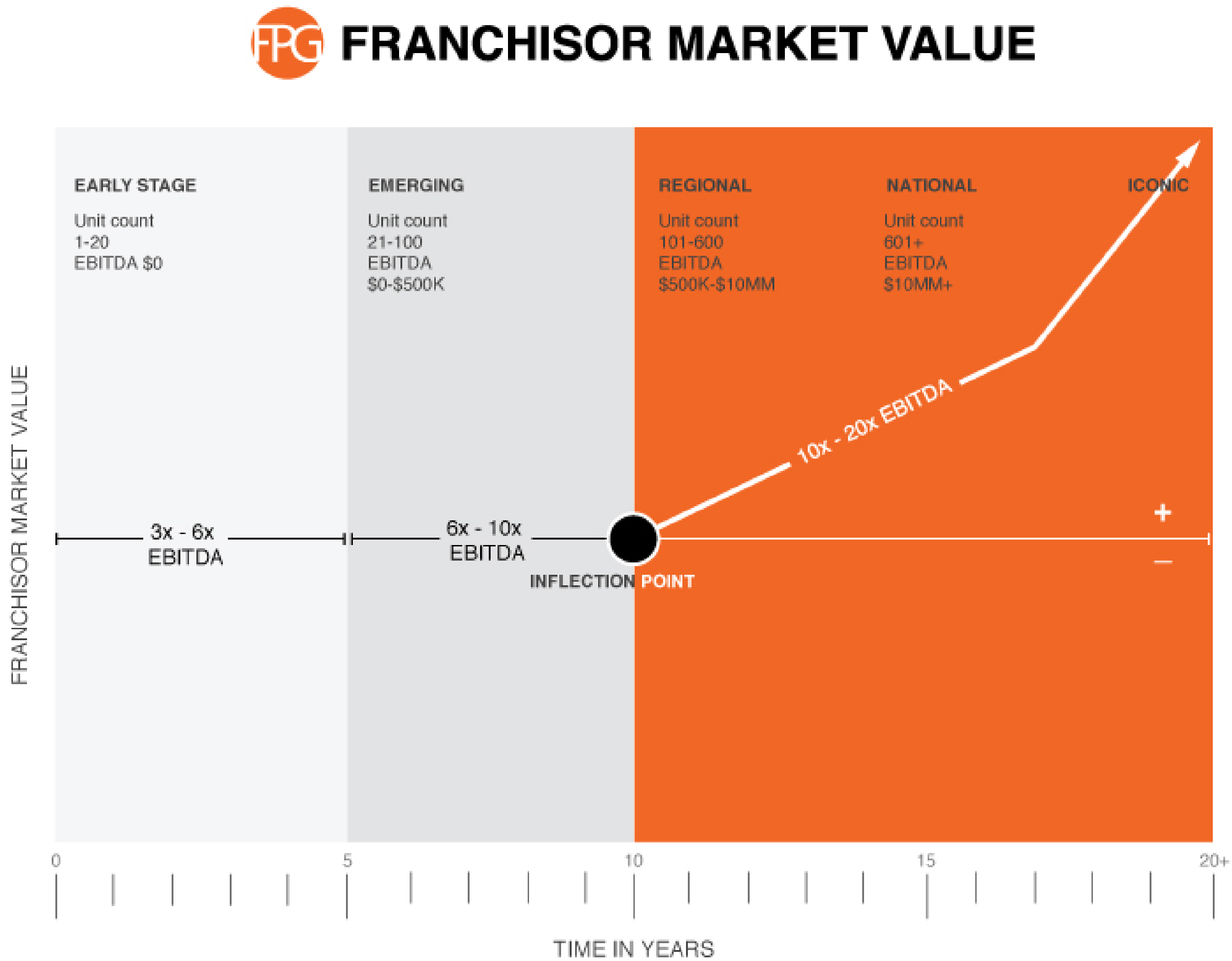
What would happen if customers and franchisees of any brand in any industry believed the benefit they continually received by doing business together exceeded what they were paying in price or royalties?

- Would word get out?
- Would new customers want to try the product or service?
- Would franchise candidates want to join this system?
- Would suppliers want to bid on the business?
- Would revenues grow?
- Would royalty collections grow?
- Would banks finance this venture?
- Would venture capital or a strategic buyer pay a premium for this business when it was time for the franchisor to sell?
- When it was time for franchisees to exit, would their business also command a premium?

When the franchisor gets their value equation in alignment with the expectations of franchisees and customers, the entire brand constituency and ecosystem will work together to ensure brand success in ways the franchisor can never predict.

Market Valuation by Life Cycle Stage

Brands which successfully navigate Early Stage and Emerging Status and become Regional, National, and Iconic brands command a premium market valuation starting at 6X EBITDA and climbing as high as 20X EBITDA. The market is small for Early Stage and Emerging brands who do not exhibit the best predictors of success and strong consumer and franchise opportunity value propositions. Franchisors looking to raise capital or exit will do so at a discount as defined in the following infographic.



While it takes most franchisors more than 10 years of franchising to amass 100 or more operating franchisees or territories, it may only take another 10 years to get to 300-500 units or operating territories. We advise franchisors to “go slow to go fast” — take the time to make the investments necessary to perfect their franchise offering and consumer-facing operating model.

In 30 years working with more than 120 brands, it has been FPG’s consistent experience that well-planned and skillfully-executed business models always create a breakthrough, but almost always after they achieve the benchmark of 50-100 successful units or territories open. The data would support our assertion that franchisors who try to build the plane and board passengers at the same time most likely crash. Eventually, a steady stream of one-off franchisee operational issues will take the franchisor away from strategic thinking, mire the franchisor in the weeds, and eventually cause the brand to suffer a slow death by 10,000 paper cuts. Competent franchising professionals will become dissatisfied and quit, taking valuable brand competency and experience with them. Franchisors are then faced with hiring new people, overextending staff, or promoting people into positions where they are not equipped to win.

For those who successfully "go slow to go fast," cautious yet highly aggressive investors who have been watching the brand from the sidelines start joining in great numbers. Chains who recruited 6-10 franchisees per year in the past and start recruiting more than 20 franchisees per year or more at this stage. Existing franchisees also expand at a more accelerated rate, creating a pace of 40 or more units or territories per year. That's how chains accelerate from 100 to 500 territories in a short 5-10-year window.

Annual Franchise Sales by Life Cycle Stage

Early Stage	Emerging	Regional	National	Turnaround	Resurgent
1-6	7-12	13-30	31-100	Situational	Situational

Often, once a chain achieves royalty self-sufficiency and have already made the investments necessary in leadership infrastructure to scale the brand, 40%-75% of the royalty and continuing fee revenue collected flows through to the bottom line, driving cash flow and equity.

The new growth acceleration franchisors experience as they progress comes from two sources:

1. Heightened new franchisee interest driven by increased brand recognition
2. Organic growth franchise existing franchisees expanding

Many franchisors will look at a chart like this and think, "We need to recruit franchisees as fast as we can," assuming the golden ticket is franchise sales results. This couldn't be further from the truth.

A strong franchise sales effort can elevate the brand for 1-2 years tops. Eventually, brand growth is dictated by the franchisees. Franchisee recruiters can't talk candidates past poor operational performance and poor franchisee validation.

Franchise sales results are a direct byproduct of the perceived strength of the brand, past franchisee performance, and how franchisees and candidates perceive the future success of the brand. The franchisees and franchise candidates' perceived value of the franchisor's operating model will be a function of these five previously discussed factors:

1. Uniqueness of the products or services
2. Profitability
3. Defensibility
4. Perceived customer value
5. Long term sustainability

If a brand consistently delivers on all 5 points above and successfully graduates from one growth stage to another, the chain hits a tipping point, a place of effortless and accelerated growth. Post-tipping point, a brand will often more than double the number of new territory/unit openings the brand normally experiences, and if successful will often double again as the brand continues to graduate stages. This rate of accelerated rate of growth, if not anticipated and managed effectively FROM 1-3 YEARS PRIOR TO THE TIPPING POINT, will often lead to crippling operational and organizational breakdowns. That is why FPG asserts that brand must always be consistently planning 3 years in advance.

If the organization isn't consistently developing its staff, soon growth will outpace the organization's capacity to keep up. Sometimes success doesn't breed more success, it creates massive future breakdowns.

CONCLUSION

Where Do We Go From Here?

FPG believes we will soon be entering a new era of franchising we call Franchising 3.0, which will be about perfecting franchising as a brand strategy by better aligning franchisors', franchisees', suppliers', and customers' interests.

FPG introduced this work as tool and roadmap for all stakeholders to use to make the smart strategic decisions necessary to build a profitable, valuable, and sustainable brand with its own identify, life, value, and forward momentum.

FPG's aim is to provide brands what franchisors already aim to provide franchisees: a proven business format and business platform which predictably drives results. We seek to help articulate and usher in **Franchising 3.0**, which we see as **mastery of the franchising business model throughout its growth stages.**

When both the consumer-facing business and franchising business model are simultaneously masterfully executed, the brand experiences a Flywheel effect, generating its own momentum and seemingly a life of its own. This momentum lifts the brand and drives value and profitability for all brand stakeholders. The Flywheel effect will continue until it is disrupted by internal or external threats or a combination of the two.

Many franchisors see franchisee recruitment as the driving force behind a brand's success. FPG asserts that franchisee recruitment results are a natural byproduct of the pull demand the brand creates when the Flywheel is spinning, franchisees are performing at a level which meets or exceeds expectations, and their brand story begins to be told to their target franchise buyer.

Regardless of the category, industry, or investment level, franchise brands materially grow and evolve along a consistent and predictable linear path from Early Stage to National brand status. The tactics, strategies, and culture the brand develops to drive the first two stages of the franchisor growth curve become barriers to performance as the brand moves towards the tail end of its Emerging Growth stage. FPG identified what we see as each stage of the linear brand path in which the franchisor must plan for reinvention — points we labeled as inflection points. We articulated what we see as the key opportunities and common mistakes brands make during each stage of their growth curve, either perpetuating their Flywheel effect or sending the brand into a Turnaround situation. We believe the franchisor's strategy should be consistent with and determined by which stage they occupy in the FPG Franchisors Growth Curve©.

Lastly, FPG believes franchising has entered into a supply-and-demand disequilibrium which is creating a market disruption which will eventually force self-examination which will drive transformational change.

Franchising 3.0: An Open Invitation to Franchising Thought Leaders

FPG believes franchising 3.0 is coming. FPG's models suggest current franchise opportunity demand can support only 1,000 of nearly 4,000 franchise brands in existence. Currently, new franchisees only account for 13,000-15,000 of the over 400,000 new business starts, which is less than 4% of new business starts.

Franchisors can either create more value to capture more of the 400,000 new business starts or risk being a casualty of overdemand and undersupply. Economic theory dictates that to increase market share, brands should either reduce franchise candidate's cost of entry or increase candidate's return on investment (or some combination of the two). Driving value and maintaining price is always the better solution.

Franchising 3.0 will be about franchisors creating franchise systems which increase value for both franchisees (by perfecting their franchising model) and customers (by perfecting their consumer-facing model).

We invite you to critique this work and submit your own stories, data, opinion, and theory which FPG will compile into a FINAL FRANCHISING 3.0 document to be republished by Jan. 1, 2020.

Submit your ideas, posts, and critiques to FPG's Franchise Thought Leaders LinkedIn group page.

Additionally, FPG will be hosting franchising best practice events to provide franchisors a forum to discuss and execute Franchising 3.0 strategies and tactics as we now define them. You can learn about upcoming events and webinars by visiting our website.