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Joe Lindenmayer: The Franchise Insider

Franchise Ownership in the New Economy

Before investing in a franchise, consider how the franchisor has reacted to the recession.

By Joe Lindenmayer | February 25, 2010

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The unofficial results of the past 14 months have shown that approximately 200 to 400 franchise systems are struggling. Many have ceased franchise growth or even closed down entirely. But when you compare that to the numbers of non-franchise businesses that have shut their doors or are on the verge of doing so, the resilience and strength of the franchise model shines through. A well-oiled franchise system has the capability to fight against the forces pulling down small independent businesses. In large part this is because the franchisor has a vested interest in the survival of each and every franchise owner and will do all it can to ensure the network's success.

So why discuss the several hundred brands that are struggling? That's Darwinism at its best. Although the franchise business model has proven strong in tough economic times, franchises are not immune to the credit crunch and shrinking economy. The franchise systems that have failed or are on the verge of failing were not prepared to handle the economic challenges. They may have suffered from substantive flaws in their model, personnel, vision, financial means, or a combination of factors. While we'd all like to forge ahead and not look back at a tremulous 2009, it's critical to evaluate the good and bad business decisions that companies were forced to make under pressure. If you're considering owning a franchise, it's in your best interest to have a clear roadmap of how the system of your choice has fared over the last few years, and an understanding of their strategy for success in the new economy.

These are the four most important questions to ask before you invest your hard-earned money in a franchise:

1. Will the consumer of today (and tomorrow) buy what you're selling?

This may seem like an obvious question, but it's critical to avoid getting caught up in the latest fad. There are various listings put out each year of the hottest new franchise concepts, but while the allure of getting into a fast-growing or innovative business may be strong, consider whether it has the staying power to survive the next 10 years--or even the first one or two. Make sure your concept will hold consumer value for at least the duration of your franchise agreement. Research pending technological advances that threaten to make your product or service obsolete. If you are looking at a new concept, evaluate emerging "copycats" that can potentially undercut your price or market share.

2. Do the company leaders have what it takes to survive the challenges ahead and make great strides in prosperous times?

There were many business leaders who predicted the recession. But the fact is that you didn't have to foresee the timing and severity of the downturn in order to have a clear plan of how to survive an economic crisis. So, did the franchise system you're considering have a plan in place to keep driving sales in a recession? If not, you'll have to evaluate the new processes, programs, services and products that were put in place in order to help the company offset the negative impact of the downturn. Furthermore, you need to examine the company's strategies for taking advantage of the economic uptick.

Reviewing the franchisor's FDD this year will give you great insight into their average unit revenues, overall expenses relative to revenues and their budget--all of which will help you to determine whether they can live up to their promises and your expectations. If a system is sustaining itself primarily through revenue from franchise fees, you can surmise that it will have difficulty staying the course against competitors operating off the organic growth of their system. It's not that investing in a franchise from a new system that may not have built up royalty or system sales is necessarily a bad decision. However, the tight credit market and delayed openings will strain a franchisor that does not have the financial cushion to retain key support programs and staff.

3. How do existing franchisees feel about the franchisor's response to the recession?

In researching a franchise opportunity, take note of the accessibility of the senior leadership. Ask franchisees how often they saw the corporate staff in their market. Did executives attend meetings and hold conferences where they brought value and showed their ability to make tough decisions with a long term and strategic solution in mind? Was there an open flow of communication, idea sharing and troubleshooting when the waters got rough, and was everyone paddling in the same direction?