WHITE PAPER

Three Restaurant Franchising Myths Debunked

Operators may think franchising is too expensive or difficult, but knowing the facts can help a restaurant grow.

By Emily Wheeler
Harold L. Kestenbaum

Sponsored by:

Restaurants have been using a franchising model for expansion since the 1950s, and clearly, it works. In 2011, there were approximately 186,000 franchised restaurant units, an increase of more than 2 percent from the previous year, according to the report "Franchise Business Economic Outlook: 2011." But many small restaurateurs don't know how to get started, or fear that franchising will be too difficult, and so they hesitate to employ it as a method of expansion. Franchising, however, is easier than many people think.

This white paper, sponsored by Harold L. Kestenbaum, the Long Island partner in the San Francisco-based law firm Gordon & Rees, will discuss the benefits of franchising, and answer three common myths about the process.

Benefits of franchising

One of the biggest concerns restaurant owners face when considering expansion is capital. Opening a new restaurant can cost up to $500,000, according to a survey by RestaurantOwner.com, and it can take up to a year for a restaurant to break even, let alone start making a profit. But franchising offers a way to expand using other people's money. Instead of having to secure a bank loan, people will pay a restaurant owner for the proven business model, thus assuming the risk while guaranteeing an income source for the original owner through royalties.

At the same time that franchising minimizes risk for the owner, it also opens up new growth opportunities. Restaurants can be seeded in new markets across the country or even around the world. By partnering with a franchisee, the restaurant owner can share his concept without having to be physically present in the geographic location.

Questions to ask when considering franchising

- Is the operation proven and does it make money?
- Has the restaurant been open for at least six months?
- Is good management in place?
- Is $100,000 to $150,000 available in capital to invest in the program?
- Is legal representation who is well versed in franchising available?

Source: "So You Want to Franchise Your Business"

And success breeds success. Washington, D.C.-based hamburger chain Five Guys, for example, has opened more than 750 franchised restaurants since 2002. By opening a restaurant in one location, the owners were able to test the concept's popularity and then open more restaurants in the same market.

Franchising also allows control of the image. Five Guys prides itself on offering high-quality, custom-made hamburgers and artisanal French fries. As part of every restaurant, the location where the potatoes to make the French fries was sourced is prominently displayed, reinforcing Five Guys' image of using high-quality ingredients. Details such as the potato signage can be included as part of the franchise agreement, ensuring brand consistency and a positive customer experience, no matter which location a guest chooses.

Myth one: It's too expensive to start and run a franchise

To successfully start a franchise operation, operators should have between $100,000 and $150,000 in available funds. Be prepared to spend this money on:

- A franchise consultant
- An operations manual
- A website
- Putting together a training program
- An experienced franchise attorney

Many restaurant owners are operating on slim profit margins, and are hesitant to spend the capital needed to start a franchise. The good news is, help is available.

While beginning a franchise restaurant does require capital, loan options are available.

Investor options include:

A bank loan. This is a common route that many would-be franchisors take, and when available, it is an excellent option. Especially now, when interest rates are low, loans can be obtained for little money. However, many banks hesitate to back such a speculative investment, so do not be surprised if the application is rejected.

Venture capitalists. Venture capitalists are more willing to invest in a new, untried business model, but they will require a great deal of equity, including control of the company.

Private loans. Because the amounts needed are low, it may be possible to borrow the necessary money from friends and family. Whether it's from one well-heeled family member or a group of friends who each contribute a small amount, private loans tend to be the best option. However, as with any other type of loan, it is a good idea to state, in writing, the terms of the loan and when it will be paid back.

Many franchisors worry about how they will sell franchises once they are ready to do so — how, they wonder, will they find people willing to open a restaurant and able to meet their high standards? There are franchise sales groups who match franchisors and franchisees. These groups do the work for the franchisor, and ensure a supply of potential operators who are a good fit for the restaurant franchise.

Myth two: It's too hard to enforce consistency

The cornerstone of a successful franchise is consistency. Customers expect when they walk into a franchised restaurant that they will see the same décor, menu and level of service, no matter where the restaurant is located. Potential franchisors worry that by franchising a restaurant, they will not be able to ensure quality control and the brand will be diluted.

To ensure brand consistency, there are three steps to follow.

Choose the right franchisee. Make sure to award your franchise to a franchisee who is enthusiastic about the concept and understands the core that makes the restaurant great. If the restaurant focuses on seasonal ingredients and made-to-order meals, choose a franchisee who is passionate about those items. A franchisee who is committed to the concept and understands the purpose behind the restaurant is more likely to be consistent.

Train, then train some more. Proper training is essential — people can't meet standards if they don't know what those standards are. The advent of technology is making it easier than ever to train franchisees. Send videos that can be viewed on a tablet. Have a thorough operations manual in PDF form that can easily be viewed no matter where the franchisee is. Regularly invite franchisees to the original restaurant to understand how it works. Develop a relationship with franchisees where they feel comfortable asking for guidance, and make sure information is easily accessible.

Have the right tools in place. Before beginning a franchise initiative, have proper tools in place. Help a franchisee know who to contact for specialty ingredients, share what POS system should be used and document all procedures, from sanitation to meal preparation to decoration. Consider creating an intranet where all franchisee materials are kept and can be accessed, as well as a "help board" where questions can be asked.

Less than 15 percent of lawsuits filed were against a business, and only between 5 and 8 percent of lawsuits were filed against a small business.

Source: Klemm Analysis Group

Myth three: Lawsuits will happen

The perception is that the United States is an increasingly litigious society, making many franchisors worry that they will be sued, whether by patrons who slipped on a wet floor or franchisees who feel they were unfairly treated. In fact, according to the study "Impact of Litigation on Small Business," conducted by Washington, D.C.-based research firm Klemm Analysis Group, less than 15 percent of lawsuits filed were against a business, and only between 5 and 8 percent of lawsuits were filed against a small business.

Not only is the likelihood of a lawsuit small, but there also are proactive steps franchisors can take to protect themselves.

Hire an experienced franchise lawyer. Many business owners think that their business attorney can advise them on how to set up the franchise program. But franchise laws are specific and vary from state to state. It is incumbent upon the franchisor to hire an attorney experienced in franchise law. When choosing a franchise attorney, consider their experience and fee structure.

Know the laws. Franchising is a highly regulated industry that requires compliance with both by state and federal laws. Know the basics for each state the franchise will operate in, as well as the federal laws. Regulations can change frequently, so stay up to date. This is where an experienced franchise attorney can be invaluable, as he or she should be familiar with all of the laws and be able to inform franchisors of any changes or potential changes to regulations.

Stay compliant. Be compliant, not complacent. Just because a franchisee is compliant with the laws at one point does not mean he will stay that way. Regularly check on locations to make sure they are in compliance with local, state and federal laws. Create checklists that franchisees have to fill out weekly or monthly, and keep records. Have clear penalties in place for franchisees who do not stay compliant, and state up front what will happen to those found to be in violation.

Franchising a restaurant can be profitable and satisfying. Don't let misconceptions keep your restaurant stagnant. Growth is a valuable commodity and franchising can accelerate this. Hiring franchise experts who will help develop clear training guidelines can go a long way to make the franchising process go smoothly.

About the sponsor: *Harold L. Kestenbaum is the franchise transactional specialist in the law firm of Gordon & Rees. He is based in their Long Island office. Gordon & Rees is a full-service law firm focusing on complex litigation and sophisticated business transactions. The firm employs nearly 500 lawyers in 32 national practices. Gordon & Rees has more than 20 U.S. offices in 14 states and is admitted in 27 U.S. jurisdictions, as well as Canada, England, Wales and Hong Kong.*