



THE AUTHORITY
ON FRANCHISING

**The State of Emerging Franchise
Systems: Challenges and Opportunities**

Part Two

Ed Teixeira, COO Franchise Grade

Challenges and Opportunities

This is part two of a two-part report that analyzes and presents key information regarding the performance and composition of emerging franchise systems, consisting of franchises with 100 or less franchise locations. In part one we presented an overview of new franchise growth. We studied ten years of startup franchise growth for 1,207 franchises beginning in 2007 and then organized the number of locations into eight groups with 0 to 100 locations. The study revealed that; 20% of those franchises that started 6 to 10 years ago had 100 or more location, 42.2% of the franchises had 26+ locations 5 years from startup and 24.6% had 26+ locations 4 years after startup. On the reverse side 30.6% of the franchises had 1 or 0 locations after 5 years.

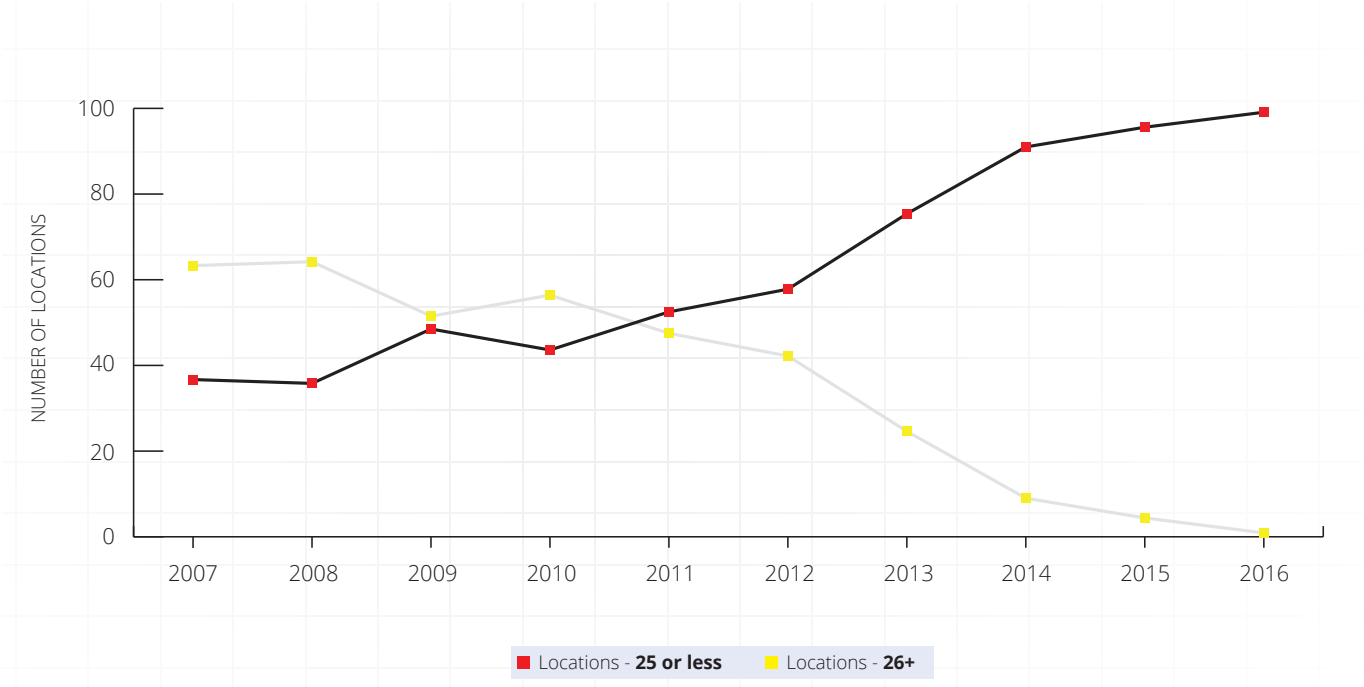
We asked Robert Cresanti, CEO of International Franchise Association (IFA) to comment on the subject of emerging franchises:

“New franchise brands are emerging daily, giving franchise prospects more choices and opportunities than ever before, speaking loudly to the level of economic contribution franchise small business owners bring to the nation’s economy. Emerging franchise brands will continue to fuel sustainable growth, competition, and innovation all which are essential in addressing and resolving concerns and challenges facing the business model.”

Robert Cresanti, IFA President & CEO

Cause For Optimism

An important component of our research was to drill down deeper into the 1,207 franchise systems to identify which franchise sector they came from, the growth of these franchises by sector and the investment breakdown. The results indicated that a number of emerging franchises have the potential for dynamic growth. In order to achieve successful growth start-up franchises need to follow certain guidelines when they launch their new franchise. For those who are either considering a start-up franchise program or are having difficulty growing we sought insight and advice from emerging franchise CEO's, that grew their franchise brands to over 100 locations in less than ten years and from franchise experts. They share their experience and offer advice and suggestions to emerging franchises and businesses considering franchising their business.



Although there are examples of start-up franchises failing to successfully grow during their formative years, 42.2% of franchise systems achieved reasonable growth after 5 years from their launch. With few exceptions, successful start-up franchises will have 1-3 franchise locations after their first year. A start-up franchise with 26+ locations after 5 years is an acceptable rate of growth and provides a foundation to continue their franchise development.

Emerging Franchise Systems by Franchise Sector

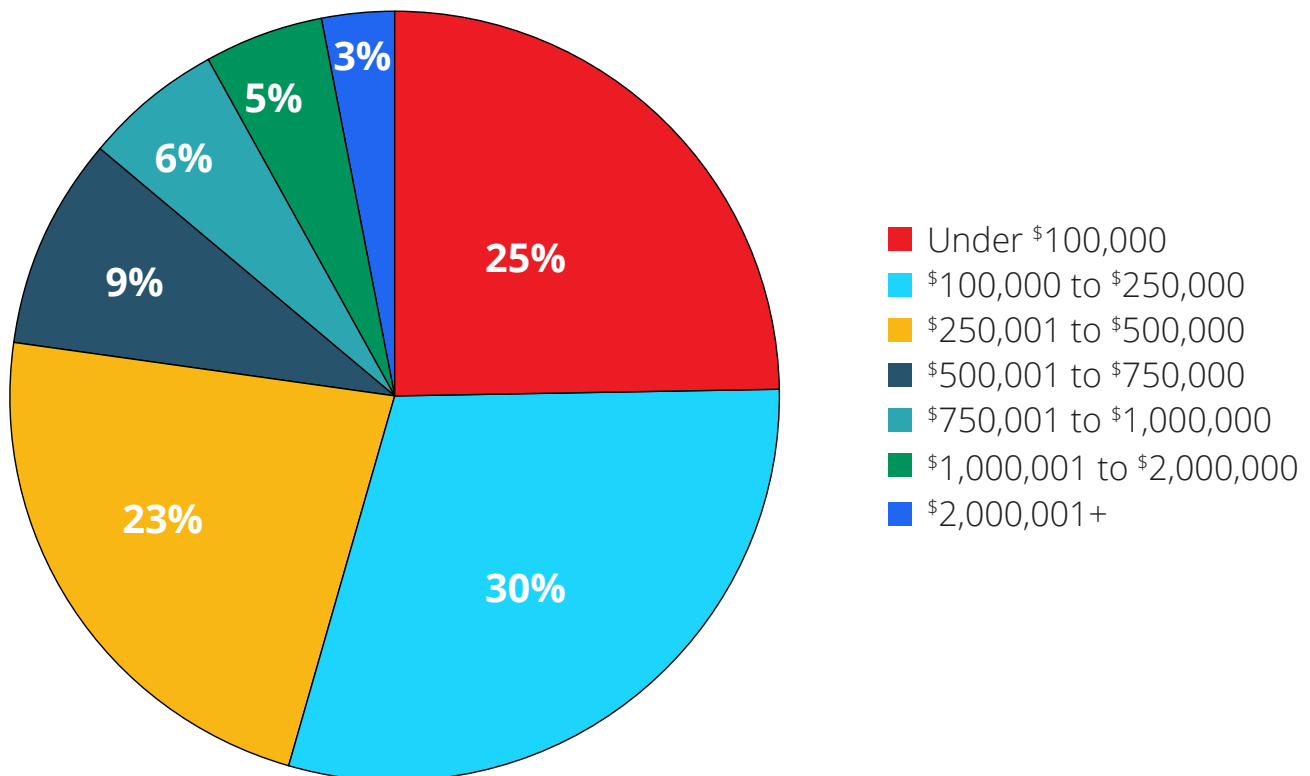
When we analyzed emerging franchises by the major franchise sectors we found Personal Services, Quick Serve Restaurants and Commercial and Residential Services accounted for 61% of the emerging franchises in our database. Personal Services represented the largest sector at 27%. Given the current growth and popularity of Children's Services, Homecare and Fitness franchises these numbers aren't surprising.

On the other hand, the Lodging, Real Estate, Automotive and Retail Food Sectors totaled 12% of the emerging franchises in our study. These low numbers are most likely the result of the investment these franchises require and the competitive challenges from comparable non-franchised businesses.

| SECTOR | FRANCHISE SYSTEMS | PERCENTAGE |
|-----------------------------------|-------------------|-------------|
| Automotive | 49 | 4% |
| Business Services | 99 | 8% |
| Commercial & Residential Services | 186 | 15% |
| Full Services Restaurants | 79 | 7% |
| Lodging | 47 | 4% |
| Personal Services | 327 | 27% |
| Quick Service Restaurants | 232 | 19% |
| Real Estate | 33 | 3% |
| Retail Food | 46 | 4% |
| Retail Products & Services | 109 | 9% |
| TOTAL | 1,207 | 100% |

Investment Distribution for Franchise Systems

The table below shows the required average investment and the number and percent by sector. Investments for \$250,000 and less accounted for 55% of the franchises in the study with 25% of the brands below \$100,000.



These percent reflect the large number of Personal Services, Commercial and Residential Services and Business Services among the franchises. These sectors include many low investment franchises such as Children's Services, Homecare and Home Services some of which are home based. The higher investment franchises, such as Lodging, QSR and Retail Food require a larger investment and the low percent of these higher investment franchise sectors.

Number of Franchise Locations by Years Franchised

For various reasons, franchises achieve growth at different stages in their development. Some franchises grow at an acceptable and even rapid rate while others simply fail to grow at all. The following table shows various stages of growth and the percent of new franchises that reach each stage by years in operation.

It's interesting to note that only 1 out of 5 franchises reached 100+ locations after their 8th year of franchising.

| LOCATIONS | AGE OF FRANCHISE (YEARS) | | | | |
|-----------|--------------------------|------|------|------|------|
| | % | | | | |
| | 2 | 4 | 6 | 8 | 10 |
| 0 | 65% | 28% | 6% | 6% | 6% |
| 1 to 10 | 27% | 35% | 29% | 26% | 16% |
| 11 to 25 | 4% | 12% | 18% | 17% | 16% |
| 26 to 50 | 3% | 12% | 23% | 14% | 16% |
| 51 to 100 | 1% | 7% | 9% | 18% | 22% |
| 100+ | 1% | 5% | 16% | 20% | 26% |
| | 100% | 100% | 100% | 100% | 100% |

23% had 26 to 50 locations after 6 years in operation. Conversely, 29% of franchises had only 1 to 10 locations after 6 years. Emerging franchisors should compare their growth to the results in this table.

INSIGHT AND ADVICE FROM THOSE WHO KNOW

To gain feedback and provide meaningful advice to emerging franchises we spoke with two highly successful franchisor founders and two highly experienced franchise consultants. The franchisors experienced significant growth as emerging franchises and have been graded A+ by Franchise Grade for their top franchise performance.

Tony Lamb, CEO Kona Ice

In 2007, Tony Lamb founded Kona Ice after deciding that he wanted to build a better ice cream truck. By the end of the year, he had designed and produced five prototypes. Kona Ice began franchising in 2008. In October 2012, the company launched the Kona Mini, a smaller replica of the Kona Ice truck, to sell shaved ice indoors during winter months. Kona Ice was recognized on Entrepreneur Magazine's Franchise 500 list in 2013. The company was also named the top new franchise and rated the 27th fastest growing franchise in the United States.

This year Kona Ice will have 1,000 franchisee owned operations in 48 states. In 2017 Kona will add 140 new franchises and 66 will be 2nd or 3rd franchises. Tony attributes the tremendous success of Kona Ice to several factors.

The Kona Start Up Strategy

"When the franchise started it had a group of profitable corporate locations. Rather than burden franchises with the debt and capital used to build and launch the franchise, for the first four years, we used the income from the corporate operations to pay for franchisor salaries.

Kona Ice franchisees pay a fixed royalty which allows each franchisee to know how much they will pay and enables them to earn more as their revenues rise. Although franchises can differ from brand to brand in the case of Kona, we didn't want to be concerned with royalty audits and franchisee under-reporting. I don't believe that every business is franchiseable and not everyone can launch and operate a franchise company."

INSIGHT AND ADVICE FROM THOSE WHO KNOW

Kevin Wilson, CFE. CEO Mosquito Joe

Kevin began his career in consulting with Bain and Company, where he founded Benny's Bagels, a business that franchised bagel stores throughout Texas. Kevin became a partner with Envest Ventures and oversaw \$160M across three funds that made over 28 investments, four of which were franchisors. After meeting the founders of Mosquito Joe, he was sold on the need for the services and the opportunity for franchisees and was excited to build a great and lasting company.

The Success of Mosquito Joe

"When we launched Mosquito Joe as a franchise opportunity we took a very analytical approach and did the following. First, we established a clear strategy for the company supported by a detailed business plan that projected out five years. Once this was developed, we raised enough capital to execute the business plan, which included some buffer in case we had slippage in the plan. It also allowed us to invest early on in resources required, including a franchise development budget of \$400K in the first year. Finally, with the capital raised, I could recruit a very strong and experienced team and pay them market-based wages, all three of these steps – the strategy, the capital and the people - are critical to form the foundation that supports growth."

"I think it's very important for all franchise systems to have a strong organic development program. This means a strong sales process with an experienced development team. It also means an analytical marketing department that can assess the best places to spend money. In the early years, we spent a lot of money and tested many things to see what worked for our concept. Then, we continually adapted and optimized our strategies as we grew. It has never been a "set it and forget it" kind of program."

"I would recommend attending IFA events where you would expect to see either franchise development or marketing executives, and ask them what has been working for them. Franchising is a collaborative industry, and building a network of franchising colleagues is a powerful tool. There are several different consulting firms that have a focus specifically on franchising that would be helpful as well."

INSIGHT AND ADVICE FROM THOSE WHO KNOW

Lori Kiser CFE, CPC. CEO The Decide Group

Executive Leader and Coach with over 30 years' experience in the franchise and travel industries as franchisor, franchisee and former president of FranChoice. Starting her career as a Slurpee Girl at a family owned 7-Eleven provided a true education on the value of always showing up with enthusiasm, determination, being direct and most importantly a sense of humor!

Connect with Lori at www.lorikiser.com.

Lori's Franchise Expertise

"If you are thinking about franchising.... take Stephen Covey's advice "always start with the end in mind" and add Lori's advice "have an exit strategy mapped out". Imagine you have a successful consumer business that operates profitably, and you want to franchise your concept with the end goal having upwards of 500 units in North America. History and a lot of important research conducted by Franchise Grade will tell you that it generally takes 8- 10 years for a franchisor to get to 100 operating franchisees. With 30 years of franchise development experience, I've learned that when a franchise starts franchising, it's not that difficult to sell the first 10 -20 franchisees as this is generally friends, family and raving fans. But onboarding, training, managing and helping this first group breakeven and then shortly after becoming profitable is a little more complicated with many moving parts. Doing it right is essential to reaching your goal of 500."

Before you jump into franchising, four critical facts to keep in mind:

- 1.** Work out the bugs by operating 3-10 profitable locations in multiple markets
- 2.** Expand locally then regionally building a strong presence in markets close to head quarters (where you have a lot of support in place) before expanding nationally
- 3.** Understand that when you become a franchisor, you are operating two businesses – the actual operating business and then a franchise system
- 4.** Hire experts in both categories

"Undercapitalization is the biggest challenge for most start-up businesses and emerging franchisors are no different."

INSIGHT AND ADVICE FROM THOSE WHO KNOW

Gary Occhiogrosso - Franchise and Brand Strategist

Currently Gary Occhiogrosso is the Managing Partner of Franchise Growth Solutions, which is a co-operative based franchise development and sales firm. Their "Coach, Mentor & Grow Program" focuses on helping Franchisors with their franchise development, strategic planning, advertising, selling franchises and guiding franchisors in raising growth capital. Gary started his career in franchising as a franchisee of Dunkin Donuts before co-launching the Ranch *1 Franchise program. He is the former President of TRUFOODS, LLC a 100 unit, multi brand franchisor. Gary is the host of the "Small Business & Franchise Show" broadcast over AM970 in New York City.

Gary's Advice

The following are based upon Gary's experience constructing and launching several franchise companies:

1. Have a written strategic development plan
2. Find Franchisees with the same core values as the Franchisor
3. Be properly financed to fund the plan
4. Focus on Unit Economics to insure successful franchisees and great validation
5. Create a strong digital presence, using SEO & SEM to drive interested parties to the Franchise Website
6. Built a Company store in a new market and sell it once the market was penetrated
7. Review and if necessary improve the results of the business model
8. Seek professional coaching from people that have "been there-done that"

Report Summary

The data in this report confirms that start-up and emerging franchises have different rates of growth before the successful systems achieve maturity. It's critical that new franchises are built on a foundation of successful company units and launched with ample capital to fuel the development of a viable franchise network.

As franchise systems grow franchise leadership should be prepared and willing to adjust their franchise program. Too often, a floundering franchise is unwilling or incapable of making changes to their franchise, the result is wasting resources trying to sell a flawed franchise. This process requires that franchise system performance be monitored from start-up through the emerging stage. Re-evaluate your franchise development strategy yearly and focus on short term success to lay the foundation for long term growth. Every new franchisee needs to be operationally strong to support the sale and growth of new franchisees.

Most importantly, franchisors shouldn't assume they must sell 100 franchise locations as fast as possible to be successful. The development of a successful franchise system is a slow and steady process. If your franchise is struggling to grow then objectively analyze your system by utilizing expert advice including reaching out to successful franchise leaders. Above all, be willing to change and adjust when necessary.

The Data

Franchise Grade collects 2,500+ FDDs per year. The data presented in this report is based on data extracted from these FDDs. Although there have been references to the approximate number of start-up and emerging franchises throughout the United States, the data in this report is based on factual statistics from these FDDs. We believe this to be an accurate representation of start-up and emerging franchise development since 2007.

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About Ed Teixeira

Ed Teixeira has over 35 years of experience in the franchise industry. He is the Chief Operating Officer for FranchiseGrade.com. He has transacted international licensing in Europe, Asia and South America and is the author of Franchising from the Inside Out and The Franchise Buyers Manual. Ed has spoken before various groups including the International Franchise Expo, Chinese Franchise Association in Shanghai, China and has lectured on franchising at the Stony Brook University Business School. Ed has conducted seminars, written numerous articles about franchising and has been interviewed on TV and radio.

Contact Ed Teixeira at:

Email: ed.teixeira@franchisegrade.com

Web: franchisegrade.com

Phone: D: 631-246-5782

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