



Unlocking Growth: Business Franchising

Center Forward Basics

May 2024

Overview

Franchising is perhaps one of the most important business growth strategies in American history. The earliest franchises originated in the American colonies under the initiative of Ben Franklin. Through the centuries, this model has stood as a quintessential American embodiment of opportunity and entrepreneurship. In 1731, Franklin forged a partnership with Thomas Whitmarsh, who adopted the franchise concept for his printing enterprise, The Pennsylvania Gazette. Whitmarsh extended this innovative approach by establishing the inaugural "franchised" newspaper in South Carolina, known as the South Carolina Gazette.

Franchising has contributed to robust job creation and a skills development platform for small business owners and workers. Today, more than 806,000 franchise establishments exist, which support nearly 8.7 million jobs in the United States. A franchisor, or owner of the brands, trademarks, and operating system of the business model, grants the licenses for the conducting of a business under their marks, standards, and systems. A franchisee is an individual or entity granted the right to conduct business using the franchisor's trademark and business model. Essentially, a franchise is a local small business that licenses the branding and operational processes of the franchisor, but is responsible for the day-to-day operations of its independently owned business. The local owner, or franchisee, is responsible for hiring staff, organizing schedules, managing payroll, and performing all daily operational tasks, as well as local sales and marketing. At its core, franchising is about providing a pathway to business ownership for entrepreneurs through an established brand under protected trademarks. It depends on each party of the franchise relationship to meet their obligations to each other under the franchise agreement, and to ensure a consistent product or service is delivered to the consumer across all businesses operating under the brand.

Despite how it is often characterized, franchising is not an industry. Franchising is a business model used within nearly every industry. More than 300 different sectors are represented in franchising, and franchise companies cover a huge range of products and services from lodging, fitness, home services, health care, plumbing, pest control, restaurants, security, and lawn care. Against prevalent misconceptions, franchising encompasses much more than just the fast food industry with a total of 63% of franchise companies not being categorized in the food services business. In this Basic, we will take a further look at what a franchise is and what comprises a business franchising model.

Center Forward Basics

Center Forward brings together members of Congress, not-for-profits, academic experts, trade associations, corporations and unions to find common ground. Our mission: to give centrist allies the information they need to craft common sense solutions, and provide those allies the support they need to turn those ideas into results.

In order to meet our challenges we need to put aside the partisan bickering that has gridlocked Washington and come together to find common sense solutions.

For more information, please visit www.center-forward.org

A Closer Look At Business Franchising

Franchising plays a crucial role in the modern business landscape by facilitating growth, mitigating risk, and providing opportunities for entrepreneurship and collaboration. The value of franchising lies within the franchise system, giving aspiring small business owners a head start toward becoming their own boss. Along with this structure comes more accessible access to lines of credit than a traditional small business and a proven business model that may increase the likelihood of success for new business owners. The franchisor can expand more effectively than through corporate ownership, and the franchisee is able to be his or her own boss while using a proven operating system. With flexibility to both the franchisors and franchisees, franchisors can adapt their business model and expand into new markets without having to manage each location directly. On the other hand, franchisees can enjoy the independence of owning their own business within a structured framework. Consumers have often been more inclined to trust and support a brand they are familiar with, allowing franchisees to save on procurement, marketing, and brand building and management costs. Franchisors typically provide franchisees with detailed brand standards manuals and training programs to ensure consistency across locations, helping maintain the quality of products or services that underscore consumer loyalty and trust in the brand. Franchise Systems can benefit from economies of scale in purchasing, marketing, and other technology systems. By pooling resources across multiple locations, the franchisor and franchisees can optimize quality, cost and efficiency in sourcing that wouldn't be possible as standalone businesses.

It is typical in franchising that a franchisor will license, among other things, the use of its name, its products or services, and its operational processes and systems to its franchisees. Consequently, it is commonplace for a franchisor to impose standards on its franchisees, which are required under the federal Lanham Trademark Act to protect the franchisor's intellectual property rights in its registered trademark. These standards also allow franchisors to maintain the uniformity and quality of product and service offerings and, in doing so, to protect their trade names, trademarks, and service marks, the goodwill associated with those service marks, and most importantly, the consumer.

Advantages & Disadvantages

The Small Business Administration (SBA), its lending programs, and the access to capital they provide are a big part of the franchise success story. About 20% of SBA lending goes to franchising. The benefits of franchising a business include establishing new locations financed, developed, and overseen by franchisees. In contrast to organic expansion, which demands ongoing capital and internal team management, franchising enables potential growth through the provision of capital and resources by franchisees. Additionally, royalties and other fees from franchisees accrue, along with the opportunity to enhance the supply chain and overall economies of scale as the business expands.

Conversely, the potential drawbacks of franchising one's business include diminished control over franchise locations, ongoing obligations for supporting franchisees, and the necessity to adhere to legal requirements that might be at play. Compared to organic growth, which runs off of direct control of one's entire operations, when a corporation/company franchises, the success and failure of new locations will depend on the performance of their franchisees.

The Bottom Line

When franchising burst on the American economic scene with vitality in the 1950s and 1960s, no franchise-specific laws or regulations were there to greet it. On the contrary, for many years only those bodies of law governing business generally regulated franchisors and their networks. Over time, franchises were given structural features—our nation's corporate, intellectual property, and antitrust laws – to help bring them to where they are today. The federal and fourteen state governments have laws that include rules or regulations requiring franchisors to prepare a prospectus-type disclosure document containing material information a prospective franchisee should consider. The District of Columbia, and twenty-two other states, have since enacted what are commonly referred to as franchise “relationship” laws.

On the federal level, the sale of a franchise in the U.S. is governed by the Franchise Rule, enforced by the Federal Trade Commission (FTC). The Franchise Rule, which is currently under review by the FTC, requires a franchisor to provide a

Franchise Disclosure Document (FDD). The FDD is an extensive pre-sale disclosure provided to a prospective franchisee. Broken into 23 “Items” or sections, the FDD contains information about the franchisor (including the franchisor’s corporate structure and leadership, litigation, and bankruptcy history), the franchise opportunity being offered (including the fees and costs to develop and operate the franchised business, a franchisee’s obligations to the franchisor, and the franchisor’s obligations to the franchisee), how much other franchisees have earned, and other information about the franchise system. The FDD also includes a copy of the franchisor’s then-current form of franchise agreement, which governs the relationship between the franchisee and the franchisor.

Regarding pending legislative action, several bills have been introduced in Congress. The Small Business Administration Franchise Loan Transparency Act of 2021, a bill introduced in Congress in 2021, aims to ensure a minimum disclosure standard by franchises whose franchisees use loans guaranteed by the Small Business Administration. Another piece of legislation is the PRO Act, which some say could threaten and hinder the future of small businesses in America due to its perceived favor of organized labor over small businesses. Center Forward has previously written about the PRO Act in a Basic [here](#). While these represent a small sample of the changing legislative and regulatory landscape facing the franchising model and other small business owners, it is clear that Congress’s actions will have a significant impact on the economic engine that is franchising.

Links to Other Resources

- 1851 Franchise - [Should Franchise Brands Get Political?](#)
- Congress.Gov - [Small Business Administration Franchise Loan Transparency Act of 2021](#)
- Federal Trade Commission - [A Consumer’s Guide to Buying a Franchise | Federal Trade Commission](#)
- Franchise Agreement Law - [Federal and State Franchise Laws, Rules and Regulations](#)
- Franchise Law Solutions - [The Ultimate Guide to Franchising | How to Franchise A Business](#)
- International Franchise Association - [FEDERAL TRADE COMMISSION'S \(FTC\) FRANCHISE RULE](#)
- International Franchise Association - [PRO Act legislation threatens franchise small businesses](#)
- International Franchise Association - [What is a Franchise?](#)
- Investopedia - [What Is a Franchise, and How Does It Work?](#)
- Open for Opportunity - [The Value of Franchising - Open for Opportunity](#)