

# Franchise Players

National chains say their franchise owners do better in a bad economy. This recession could put that safety net to the test.

**I**N THESE DAYS OF “GREEN” EVERYTHING, human recycling is hot too. Thanks to layoffs, there’s no shortage of slightly used, perfectly good people hunting for work. Take Jon McIntosh. In 2007 the 51-year-old mortgage banker found himself downsized for the fifth time in his career and decided it would be his last.

Looking to “do something worthwhile and lasting,” he tapped his 401(k) account for \$110,000 and opened up a business providing home health care to aging boomers—thus becoming one of America’s nearly 1 million franchise owners.

With unemployment numbers spiking, there has been a surge of interest in franchises as the next bright and shiny career option—never mind the name-tag-and-funny-hat connotations. Franchised businesses make up 11 percent of the U.S. private-sector economy and take in 41 percent of every retail dollar spent. This January the International Franchise Expo in Miami, where franchisors go to show a little leg and lure some new operators, remained a hot ticket. The temptation to the entrepreneurially inclined is understandable: be your own boss with a proven brand, all the training you need, financing help and a big hand with marketing.

In past recessions, the number of franchises has actually grown faster than it has in good times, says Steve Olson, publisher of Franchise Update Media Group. Indeed, the number of franchised establishments grew at a faster pace than many other sectors of the economy from 2001 to 2005, expanding by more than 18 percent to 900,000. And the perception of franchising as a safer choice

has been a big factor driving that kind of growth. Companies that lease out franchises like to tell entrepreneurs that they’re three times more likely to make it by being a franchisee than by going solo. But even some franchise owners suspect that statistic may be more legend than fact. One study, by Wayne State University professor Timothy Bates, indicated that there is absolutely no difference in the success rate or longevity of independent entrepreneurs versus franchises. Franchise obsessives can argue about this stuff for hours.

Bulls and bears agree that it costs money to make money. Franchise fees—the onetime charge you pay up front for the privilege of tapping the brand—range from as little as \$5,000 to \$50,000. After that, the franchisee typically pays a royalty of 3 to 8 percent of annual gross sales. But the bigger hit comes in start-up working capital: The buyer may need as much as \$350,000 for the first three months to cover equipment, leases and other starting costs, according to Mark Kiekenapp, who owns LA Sunset Tans and has been active in franchising for 20 years. If that sounds daunting, there are cheaper options: Some home-based businesses in party planning, business coaching and trophy

**Pizza franchises and furniture chains are waiving fees and offering financing for new partners—with strings attached, of course.**

making, for example, require a total investment of less than \$100,000.

Olson, a trade journalist who covers the franchise world, predicts that the numbers of new franchisees will explode in this recession—provided that would-be Subway shop and U-Haul lot owners can get financing. That remains a big if. With homeowner equity down and bank-loan criteria stiffened, the number of Small Business Administration-backed loans has fallen by 56 percent since Oct. 1, compared with the year-earlier period. In a tight lending climate, notes Olson, “without a proven concept, you are dead in the water.”

If you’ve got the nerve, you can leave the banks out of the financing picture. Although the maneuver has ruffled some feathers at the IRS, it’s legal to roll your retirement assets over into a franchise. To do so, you basically start the You Corpora-



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## Smart Ideas

tion, use your savings to buy stock in You, and then use the cash you've "raised" to start up your business. Unlike people who tap their IRAs early to, say, buy a new sailboat, folks who make this move don't have to pay taxes on the rollover. McIntosh liquidated his stock and bond portfolio to start his BrightStar Health-care franchise. (One nice side effect: He got out of the market before last year's big downturn. "It was dumb luck," he says.) Ideally—okay, very ideally—he'll build a business profitable enough to shore up his retirement savings later.

With today's depressed account levels, raiding a 401(k) plan likely means selling low. But for some, the loss is worth it for a new start. Deborah Jack, 49, a former Wall Streeter, recently found herself reorganized out of a high-paying job after 20 years in the industry. Jack had a sizable holding of AT&T stock that she saw shrink by more than half. But she sold anyway, and the \$10,000 in proceeds helped her open a Fetch! Pet Care franchise in Fort Lee, N.J. She works out of her home, manages 25 pet-sitters, walkers and groomers, and says she turned a profit her first year. "I figure people will cut back on other things before they cut back on pet care," says Jack.

Some franchise ideas, of course, are more recession-resistant than others. Cell-phone stores, anything to do with senior care, and specialty cleaning services like the ones insurers hire for mold remediation are reasonably resilient, according to Olson. Other possibilities include greenish enterprises, like Cleveland-based USA Insulation, which retrofits homes to be energy-efficient. Less promising: video gaming, food and anything fad-driven.

With over 3,000 companies licensing franchises across 75 industries, someone who's franchise-curious may need help narrowing choices. Franchisesolutions.com is an advertising-supported site that's a good

place to start. You could also turn to FranchiseMart, a chain of brick-and-mortar stores that offers "pressure-free guidance" on 100 possible franchise opportunities. If you enjoy those Russian dolls-within-dolls, there's also this option: You can buy a franchise to open a FranchiseMart and help other people open franchises.

With the economy in so much trouble, even some franchise chains are having their own blue-light specials. Emerald City Smoothies will now give a free kiosk (normally a \$20,000 charge) to anyone who plunks down their \$30,000 fee to open up a store. Pizza Inn recently announced it would waive its royalty payments during a franchisee's first full year of operation. Budget Blinds will refund its \$15,000 fee if a new partner can produce \$750,000 in gross sales over three years—not an outrageous goal. Some franchises are even offering 12-month, zero percent financing to open a store.

Scratch the surface of this coziness, however, and it becomes clear that many franchisees have as many conflicts with their parent companies as plain old wage-slave employees have with their bosses. Just as with the local stereo dealer, for example, a franchise borrower who misses a payment for any reason can get socked with 28 percent

interest and penalties. Rub franchisors the wrong way, warns Susan Kezios, president of the American Franchise Association, and they can tie you to contract provisions that restrict your ability to purchase supplies. In some cases, they even have access to assets in your bank account.

Kezios's best advice for newbies: Find a lawyer who specializes in franchisee contracts. "If a franchisor is giving you a free ride," she says, "be certain they'll get it out of you some way down the road." **S**

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