Management Key To Success Of Franchise Operators, Parent Companies

COLUMBUS, Ohio – More than one-quarter of all new restaurants fail during their first year of business. About 60 percent fail within five years. Although many are independent operations, failures also occur with franchised restaurants.

One reason is that franchisees and their regional or national parent companies sometimes work at cross-purposes, said H.G. Parsa, associate professor of hospitality management at Ohio State University.

Parsa, who is housed in the College of Human Ecology, is known nationally for his research on franchise management practices. It's an area of study few researchers have focused on, although franchising accounts for nearly 41 percent of all retail sales in the United States, or $800 billion annually.

"Usually, franchising is the way to go," Parsa said. "In franchise systems, somebody has tested the product, and if something goes wrong, you have someone to talk to for some support."

However, most parent companies, or franchisers, make their money by taking a percentage of the revenue from individual stores as royalties, irrespective of those stores' expenses or profits, Parsa said So, franchisers often like to increase sales, no matter what. On the other hand, the stores(franchisees) are interested in maximizing profits, or their revenue minus expenses. If a new product or service costs too much to provide to customers, stores might hesitate to offer it unless sales increase substantially

When the goals of franchisers and franchisees collide, prudent management is key to success, Parsa said. In any franchise system, stores and the parent company each have some power, although the parent company has considerably more. How that power is wielded affects both store owners' satisfaction, and the eventual financial results for both franchiser and franchisee, Parsa said.

For example, in the early 1980s, Wendy's International decided to offer breakfast at its quick-service, or fast-food restaurants. The omelets, scrambled eggs, pancakes, and other breakfast items increased revenues, but also increased individual restaurants' expenses. The stores' extra outlay actually decreased their profits, even though the parent company was benefiting from the increased revenue.

What happened next was a classic case of using the wrong management style at the wrong time, Parsa said Many franchisees quickly figured out that their own bottom line would be hurt if they offered the breakfast program, and they decided not to participate. That prompted the parent company to try to force franchisees into offering breakfasts, telling them to either do it "or take the sign down," Parsa said. The result? Some stores filed for bankruptcy, and the breakfast concept was eventually abandoned.

This scenario has the potential to be replayed whenever a parent company wants its restaurants to introduce a new product that might generate higher volume but yield a low profit margin, Parsa said. While such a heavy-handed approach can work when franchisers and franchisees are working toward the same goal, it wasn't a good strategy in this particular case, Parsa said.

Similar problems can happen when a franchise tries to grow too fast, Parsa said. For example, Subway experienced a high rate of franchisee turnover during a time of aggressive growth, while Arby's parent company suffered when stores were permitted to pursue individual goals at the expense of the whole system.

Wendy's chose a better method later in that decade, when it launched a buffet concept called the "Super Bar." Although many store owners hesitated because of the substantial capital investment necessary and the reduced floor space for customer seating, the parent company coaxed them into trying it by offering limited expert and financial assistance, allowing time delays in implementing the concept if necessary, and helping redesign dining areas to prevent loss of seating. This collaborative approach helped the Super Bar concept become a success until changing times brought the concept to a close.

Wendy's is now known as a franchisee-friendly parent company, Parsa said, as is McDonald's, Papa John's and other companies. In his studies of various franchises, Parsa has found the most successful are those in which both the parent company and individual stores financially perform at or above the industry average. He has found that in those cases, which he calls "Progressive Franchise Systems," the franchiser/franchisee system:

- Consistently makes adjustments to their products and operations to maintain a competitive advantage.
- Is proactive in its marketing activities.
- Understands the importance of franchise relations and

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