

Benchmarking franchise performance

EIGHT STEPS TO BEST PRACTICES FOR YOUR ORGANIZATION

Barbara Carper, CPA



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PROFIT **S** **O** **U** **P**

Benchmarking franchise performance

Eight steps to best practices for your organization

By Barbara Carper, CPA

President and Founder, Profit Soup

Astute franchise executives understand the significance when franchisees underperform financially. Meeting profit expectations is critical to franchisee satisfaction: when profits are good, franchisees tend to be happy. Happy franchisees are more likely to comply with system requirements that build the value of the franchised brand. As coveted resale opportunities, profitable franchises also build the value of the brand. Brand value in the long run is critically tied to the profitability of individual franchisees. Still many systems do not provide sufficient support services targeted at improving the business management skills and financial acumen of franchisees.

Growth in franchising is generally defined by rising royalties on rising sales. Franchise systems grow through a combination of franchise development (adding franchised units) and increasing sales in existing franchises, promoting a culture that defines success as increased sales. But when a system or market matures and franchise unit growth slows, retention and growth of existing franchises becomes crucial. Profitability is key to both retention and growth. At some point every successful franchisor must develop a sincere commitment to franchisee profitability and when determining how to best invest in that commitment, many turn to internal financial benchmarking as their solution.

By embracing financial benchmarking and education as a fundamental component of the franchise model, executives can establish the importance of financial management in their network and deliver the administrative structure and skills critical to success. While franchise models typically provide a complete operational solution, many lack the training and support services to fill the franchisees' skills gaps related to the financial and management aspects of running the business. This whitepaper will explore the advantages of consistent benchmarking of franchisee's financial performance as a means of improving financial knowledge and management ability, both of which are key to profitability. It will also describe eight essential elements required to implement a financial benchmarking system in your franchise network.

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In the beginning

Faced with the declining profitability of his franchise network, a CEO once asked me pointedly, “How do we make the franchisees profitable again?” My answer was simple. “One franchise at a time.” Benchmarking defined the goal and the starting point for the process, and ultimately provided the means to achieving the goal.

At minimum franchisees must recognize when they are performing poorly and identify the steps to improvement. Identifying the “best-in-class” through an objective, measurable process provides reliable evidence of what’s possible – evidence that optimistic profit expectations are achievable. Then by identifying what the best are doing to achieve their superior results, we can pinpoint the practices that drive success. Additionally, we can locate the untapped potential in the system by determining which franchisees are underperforming, allowing franchise support professionals to target their services to where they are most needed.

Benchmarking as the solution

Financial benchmarking provides a process for solving these important business problems.

- Franchisees lack critical financial and management skills
- Franchisees don’t comply with financial reporting requirements
- Franchisees’ financial information is frequently inaccurate or unreliable
- Franchisees do not always understand how managing from a financial perspective can help them achieve better results

So just what is benchmarking and how do franchise systems use it to improve the financial acumen and performance of their franchisees? It all starts with a simple definition.

Benchmarking is the process of identifying, understanding, and adapting outstanding practices to help your organization improve its performance

Benchmark: a point of reference from which measurements of any sort may be made

Modern business practices have developed and cultivated an entire management discipline beyond this simple definition. Benchmarking is the process of identifying, understanding, and adapting outstanding practices to help your organization improve its performance. Financial results are ideal benchmark candidates and have become the standard starting point for business benchmarking since concepts like profit and cash flow are easily measured and fairly well understood. Profitability ultimately defines long-term success for any business and benchmarking can identify what the most profitable companies do to achieve that success.

Franchise systems are uniquely suited to financial benchmarking because they represent a collection of companies that use a consistent business model, making an “apples to apples” comparison achievable. Once the best results are identified, the practices that lead to those results can be investigated, shared and then implemented by others. When best practices are widely implemented, network financial performance improves.

Benchmarking is a powerful management tool because it helps to reveal business blind spots

Benchmarking is a powerful management tool because it helps to reveal business blind spots. Here is an example of a business blind spot: "We do it that way because we always have." Benchmarking can reveal new methods, ideas and tools to improve effectiveness. It can also help overcome resistance by demonstrating that particular approaches work more effectively than others. Benchmarking can be a one-off event, but is more effective when used as a consistent process focused on continual improvement.

Other significant benefits of financial benchmarking include:

- Promotes franchisees' interest in financial information. When monitoring financial performance is made simple and consistent, franchisees can more easily interpret the numbers and are more likely to use the information
- Reduces accounting errors. As franchisees apply benchmarking in their own business, they quickly realize the importance of accurate records. This leads to improvements in record keeping
- Identifies financial strengths and weaknesses so franchisees can focus their management attention on critical areas of their business
- Establishes a basis for reasonable goals. "What's a good number for an operation like mine?"
- Identifies inherent problems in recommended accounting procedures and standardized account listings
- Promotes compliance with financial reporting requirements by providing a benefit to franchisees. By complying with reporting standards, they can easily assess how their business compares to the best in the system and identify how they can improve their results
- Stresses the importance of good financial management to long term success
- Can be used to support earnings claims
- Measures the financial performance of the network as a baseline for assessing the financial impact of future initiatives
- Objectively measures trends in the network
- Elevates the status of field support staff to trusted advisors
- Improves franchisee satisfaction and reduces attrition and legal issues of problem franchises by improving profitability and communication

Designing a financial benchmarking system for your franchise

Here are eight steps to benchmarking your franchise:

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1. Make benchmarking part of your business model
2. Design a collection process with your franchisees in mind
3. Promote participation from the top down
4. Ensure the figures are correct
5. Compile and sort the data to identify the drivers of success
6. Communicate actionable information instead of statistics
7. Benchmark individual franchise results against network performance
8. Assimilate feedback and implement change

Step 1 Make benchmarking part of your business model

Making annual benchmarking part of your business model emphasizes the importance of managing by the numbers

New franchises have the opportunity to include participation as a requirement outlined in the franchise agreement. Some even choose to establish funding for benchmarking projects by mandating an annual benchmarking fee in their franchise agreement. Most agreements require franchisees to report their financial information annually, but many fail to enforce the requirement, leaving behind important actionable information.

Making annual benchmarking a part of your business model emphasizes the importance of managing franchises by the numbers. This can only occur with the visible and substantial support of top management.

Step 2 Design a collection process with your franchisees in mind

Some franchisees will have difficulty completing a survey form, and some will have more trouble than others. In general, longer forms that are time consuming to complete generate lower participation rates than surveys that are quick and simple. A careful assessment of what you need to measure (as compared to what might be nice to know) is well-advised. When in doubt, leave it out. In determining which data to collect, be mindful that there is a reverse correlation between the details required and the number of franchisees who can easily comply.

From a financial perspective there are four key areas to measure. They are:

1. Productivity
2. Profit
3. Cash
4. Risk and Return

We can measure financial performance in these four areas by collecting financial statement information in a consistent format. Keep your profit and loss statement to one page or less by combining related accounts into groups. Limit the balance sheet to one-half page or less. Combine this with a short questionnaire to collect non-financial information and your comprehensive survey form can fit onto three to four pages.

You'll need to collect financials in a consistent format to compile composites for the group. Use your recommended chart of accounts and some sample financial statements from at least three franchisees to design the balance sheet and profit and loss formats. Because many franchises do not have a recommended chart of accounts (or more often, franchisees don't use it), a well thought out survey form pays big dividends. Remember – less is more. Design your survey for the least common denominator – that is, the level of detail that all study participants can provide. If some provide the details and some do not, it is difficult to consolidate the data into a meaningful and accurate summary or composite.

A note about your recommended chart of accounts

A fundamentally sound chart of accounts aids the benchmarking process enormously. A good chart of accounts is easy to use, doesn't employ ambiguous account titles, is well organized, provides for normal *and unusual* transactions and provides the details needed to comply with tax reporting, generally accepted accounting principles, and management information reports. It is a well-known truth in franchising that consistency drives efficiency. This is as true in financial and administrative functions as it is with operational issues. The chart of accounts is the starting point for consistency in financial processes.

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The survey should include a condensed profit and loss and balance sheet. Additional information not included on the financial statements can be collected with a brief questionnaire (preferably one page). You'll need to ask questions to capture details that are used to calculate financial benchmarks, or criteria that will be used to sort the participants into smaller subgroups. Suggested questions include:

- Number of full time equivalent employees (including owners) in functional categories, such as sales, production and administration
- Size of facilities (square feet allocated to retail or showroom space versus warehouse and office, if important)
- Number of locations being reported (if reporting multiple locations)
- Number of owners actively participating in management
- Percentage of sales made on credit (for calculating accounts receivable turnover)
- Geographic region or market type (such as rural or metropolitan areas)
- Age of company (if you intend to sort your data by that criteria)
- Other questions as needed to sort data or calculate productivity measurements

Avoid asking for unnecessary or previously known information

Avoid asking for unnecessary or previously known information. If you already have the data, don't waste your franchisees' time by asking for it. For example, if you know the geographic region based on the address, don't ask the franchisee to spend time providing the information. If you previously captured the business startup date, find a way to electronically transfer the details to a file that can be imported to your benchmarking database.

When designing the survey form, contemplate the truths you expect to prove. How could they be measured? What data must you collect to measure it? Have your end results support your hypothesis without providing surplus information.

Once you've designed the survey questions and established the structure of the profit and loss and balance sheet, you'll need to deliver it in a form that franchisees can easily use. Will you provide the survey online, on paper, or in an electronic spreadsheet? Will you send it by mail, email or fax? You'll want to use the media that is most easily used by your franchisees; this likely means you'll need to provide several options.

Since you're asking franchisees to complete a *financial* survey, many will ask their accountant to prepare it for them. If you don't want to give access to the "Members Only" section of your web site to all of your franchisees' accountants, you may wish

to distribute the survey in a pdf file or electronic spreadsheet. Those franchisees who will complete the forms themselves may or may not have strong computer skills and may find it easiest to complete on paper rather than online or in an electronic spreadsheet.

Step 3 Promote participation from the top down

Sending the survey form with a pleasant cover letter will be sufficient to get your best franchisees to participate, but the rest will require additional prompting and support. As with any major initiative in your organization, you'll need to develop a marketing plan and timeline that is openly supported by top management.

The benefits of participating will not be obvious to some franchisees, especially those who lack financial management skills. The highest participation rates occur when franchisees understand the value of the information they will receive. Partnering benchmarking with a comprehensive plan involving education, information (the benchmarks) and action plans (best practices) will greatly enhance the benefits of benchmarking. Offering education at a convention or special session that coincides with the launch of the survey will increase participation – especially in the first year of the project. This is a great strategy, but can backfire if the speaker is not an exciting and skilled presenter. While your CFO may understand the financials well, unless you would describe him or her as a persuasive and entertaining speaker it would be wise to hire an accomplished professional presenter for the launch.

Your franchise support staff will play a pivotal role in driving participation. The best results are achieved when they take an active role in collecting data. This may mean they are accountable for participation. They may even complete survey forms for certain franchisees. Competitions or financial incentives based on the percentage of the territory that participates can produce good results.

Finally, there's no pressure like peer pressure. Let your most successful and respected franchisees be the flag wavers for the initiative. Get their buy-in by rolling out the process as a pilot for your "legacy group" or by involving them in design and development decisions. There are times when a phone call from a respected peer is more persuasive than a call from the CEO.

As with any major initiative in your organization, you'll need to develop a marketing plan

Step 4 Ensure the figures are correct

You'll need to identify errors and fix them

Some of the data you receive from franchisees will be incorrect. You'll need to identify errors and fix them. You can do this efficiently by using technology to discern common problems. Be watching for these problems:

- Payroll entries for withholdings and employer taxes recorded improperly
- Loan payments recorded as expenses instead of debt reduction
- Failure to identify or adjust the current portion of long term debt
- Lack of payroll allocations – not classified between wages and taxes or between types of employees (direct labor versus administration)
- Omitted depreciation entries and other year end adjustments
- Negative balances in accounts that are normally positive

You'll also need to provide guidance to promote consistent accounting. Give thought to how you will handle these issues and provide instructions with the survey or in your operations manual.

- Cash versus accrual – encourage using the accrual basis if inventory or accounts receivable are important in your business. The accrual basis matches revenue with expenses for a more accurate measurement of profit
- Account classifications – use detailed instructions to encourage franchisees to categorize expenses consistently

Step 5 Compile and sort the data to identify the drivers of success

Financial benchmarking is a poor candidate for analysis by spreadsheet

You may be tempted to compile your results using a spreadsheet program and an advanced user could work through the many gyrations needed to make it work, but you'll be far better served by using a database. A little Google research of "spreadsheet versus database" will quickly point out the many reasons why financial benchmarking is a poor candidate for analysis by spreadsheet.

On the next page is a list of common financial metrics to benchmark. Choose no more than 15 of these to share with your franchisees. Less than 10 would be better. You may decide to calculate more benchmarks for your purposes of assessing your performance as a franchisor, but publish only the most important benchmarks so franchisees can focus on the most significant issues without becoming overwhelmed by a volume of detailed statistics.

Productivity

Sales
Sales per employee
Staff costs per employee
Sales per labor hour (for service businesses)
Staff costs per labor hour (for service businesses)
Sales per customer or average invoice amount
Sales per selling square foot
Sales to assets
Equipment costs as a percentage of sales
Gross margin return on inventory (for retailers)

Profit

Cost of goods sold percentage
Gross profit margin
Staff-related costs as a percentage of sales
Selling expense percentage
Occupancy expense percentage
General and administrative expense percentage
Owner's discretionary profit dollars and as a percentage of sales (profit before any compensation is paid to owners)
Net profit margin
Earnings before interest, tax, depreciation or amortization

Cash

Current ratio
Quick ratio (only if inventory is important)
Cash ratio
Inventory turnover
Inventory turn days
Accounts receivable turnover
Accounts receivable collection days
Accounts payable turnover
Accounts payable days

Financial Strength

Return on investment
Return on total assets
Debt to worth

Publish only the most important benchmarks so franchisees can focus on key issues without becoming overwhelmed by a volume of detailed statistics

You may find you may find other, more relevant industry specific benchmarks in trade publications and your operations manual.

Basic Financial Statement Information

It is useful to compile your financial information into three basic presentation tables. This data will become the source of your analysis.

- Median Benchmarks
- Common-sized Income Statement
- Common-sized Balance Sheet

If your income statement contains too many lines to fit onto one page, you may consider showing some of the details on a separate table so that the big picture of profitability can be gleaned from a single page. For example, if your income statement depicts sales by department, show total sales on the income statement, and show sales by department on a separate schedule.

Median Benchmarks

By presenting median benchmarks for important ratios the information is not distorted by a few unusual participants, as happens when using averages. On the preceding page you will find a list of possible median ratios that could be compiled as the primary benchmarks for the study.

Common-Sized Statements

Common-sizing financial statement information is a process by which each item on the financial statement is reduced to its relationship to the whole statement. For example, the common-sized balance sheet presents each balance sheet item as a percentage of total assets. The common-sized income statement presents each item as a percentage of total sales.

Common-Sized Balance Sheet

This statement depicts, on average, the proportion of company resources invested in various assets, and where those financial resources came from – creditors or owners.

Common-Sized Income Statement

This statement portrays, on average, the percentage of each sales dollar spent on various expenses, and how much remains for profit.

Calculate the median benchmarks and common-sized statements compiling data for all study participants and you'll distinguish a composite for the middle point of your franchise network – the average performer. This is an important composite to assess over time. Since trends in this composite show the overall effect of your

improvement initiatives, the composite for all companies can be considered the measurement of your effectiveness as a franchisor.

Sorting the data

Next, you can combine companies having similar characteristics into smaller groups to identify how and why groups of franchises differ. For example, by isolating the most profitable companies, you can identify what differentiates them from the rest. In which areas do they spend less or more than the average performer? How productive is their staff? How large are their facilities? Which marketing initiatives have they executed?

You can also sort data to examine correlations between subgroups and success. For example, are companies that have certain in-house production capabilities more profitable than those who do not?

Some common groupings include:

Sales Size	By grouping companies by differing sales volume you can identify the varying financial results and challenges they can each expect
Profitability	By segregating the companies having the highest profits you can identify the characteristics that contribute to their success
Age	By grouping respondents by the age of the company you can identify how financial results change as franchises mature, and can establish expected timeframes for achieving specific performance levels

Other criteria could include sales mix (product or service emphasis), customer mix (percent from business to business versus business to consumer), average order size, geographic regions, rural versus metropolitan markets or other criteria determined by project designers. Only present the additional data to franchisees if it reveals something important that can't be shown some other way. Remember, less is more.

Once the sorted reports are produced, analyze them for trends and possible causes of the trends. For example, when examining the top performers, identify the quantifiable management efficiencies that exist in high-profit companies, and then determine specifically what they did to achieve their results. This will require interviewing owners, managers and employees of your "best-in-class."

Identify the quantifiable management efficiencies that exist in high-profit companies, and then determine specifically what they did to achieve their results. This will require interviewing owners, managers and employees of your "best in class"

Step 6 Communicate actionable information instead of statistics

Pages of statistical data may be interesting to a few, but most of the franchisees will tune out when faced with pages filled with tables and numbers. You will need to identify the most important trends and explain them clearly and concisely. The goal of your analysis is to transform the figures into actionable information by describing what may have caused the trends. You can expect to spend at least half of your project time in this phase – crafting your messages into an interesting and easy to read study. At a minimum the study should:

- Identify the key drivers of success
- Pinpoint the highlights in an executive summary
- Contrast average performers with top performers
- Describe how businesses change as companies grow
- Reveal the practices that resulted in “best-in-class” performance

The final item on the list above is arguably the most important. Numbers for the sake of filling the pages won’t change results; franchisees must be able to identify action plans for success and implement them based on the information you provide.

Many franchisees would say “I’m not a numbers person”. For them, tables of number such as this are not particularly inviting.

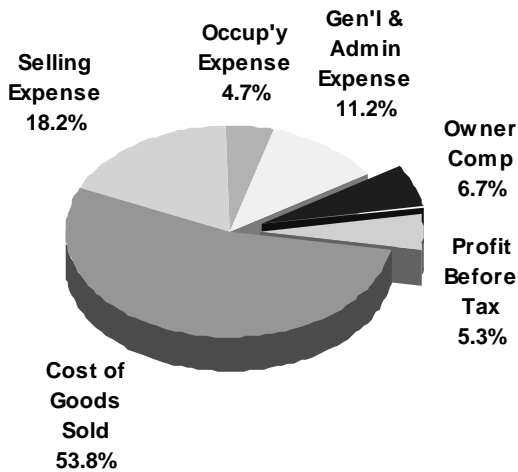
Many franchisees would say “I’m not a numbers person”. For them, tables of number such as this are not particularly inviting

	All Companies	Top Performers
Sales	100.0%	100.0%
Cost of goods sold.....	53.8	49.0
Gross profit	46.2	51.0
Expenses		
Selling expenses	18.2	14.9
Occupancy expenses.....	4.7	4.9
General and administrative expenses	11.0	10.5
Owner compensation	6.7	8.5
Total expenses	40.7	38.8
OPERATING INCOME	5.5	12.2
Other income and (expense)	(0.2)	1.6
PROFIT BEFORE TAX	5.3%	13.8%

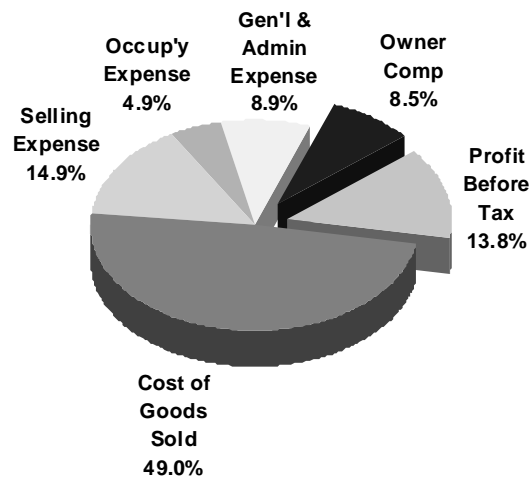
Alternatively, a graphic with descriptive text can make the figures more interesting and understandable. On the following page are charts that use the same information to show what happens to each sales dollar of the average study participant versus the average for the top performers.

Use graphics whenever possible to make important points.

All Companies



Top Performers



Use graphics whenever possible to make important points.

Top performers have 13.8% in profit before tax, plus owner compensation of 8.5%, for total profit available to owners of 22.3%. This is compared to 12% for all participating companies. Apply the 10% difference to median sales of \$2.4 million and the impact is nearly \$250,000 in additional profit dollars for those who manage expenses as efficiently as the top performers. Their profit advantage comes from managing cost of goods sold, selling expenses, and general and administrative expenses.

Step 7 Benchmark individual franchise results against network performance

Benchmark: a point of reference from which measurements of any sort may be made

The financial benchmarks determined through the survey process provide points of reference for measuring an individual franchise's performance. Determining system-wide results is just the beginning of the process. The next step is to identify, understand, and adapt outstanding practices to help your organization improve its performance.

By benchmarking individual company performance against system-wide results, you can identify who is the very best, who sets the standard, and what that standard is. Comparing company results to the standards identifies franchisees at risk of financial

Comparing company results to the standards identifies franchisees at risk of financial failure and in need of focused franchise support services

failure and in need of focused franchise support services. Alternatively, the top performers represent a resource for your network – a bank of best practices.

Your franchise support staff is the link between the information and implementation. With the information to identify the top performers and a specific process to establish goals and action plans based on best practices, franchise support professionals can provide vital implementation guidance to struggling franchisees. Benchmarking helps staff efficiently identify issues and answers and provides objective evidence to authenticate their claims.

Benchmarking can have an impact far beyond the project itself. It possesses the potential to reform all the levels of the company, modify processes, reveal flaws in what were previously considered inherent truths and affirms improvements that have been achieved

Step 8 Assimilate the feedback and implement change

Great leaders are always receptive to feedback concerning their performance. A financial benchmarking project provides objective feedback about the financial performance of your franchise system. Invariably, success of the system is a direct reflection on management's performance. How will you react if the news is not good?

The combination of the objective feedback the benchmarks provide and more subjective forms of performance assessment compel executives to ask themselves the hard questions and solve the most critical business problems thereby strengthening the network.

Benchmarking can have an impact far beyond the project itself. It possesses the potential to reform all the levels of the company, modify processes, reveal flaws in what were previously considered inherent truths and affirms improvements that have been achieved. Benchmarking can transfigure the organization, the product itself, the corporate culture and the attitudes of employees and franchisees.

In the end

How did franchisee profitability improve for the CEO I mentioned earlier? Gradually, consistently, sustainably, in the long run substantially – in the short run, one franchise at a time.

About Profit Soup

We are experts at helping business owners gain the skills, knowledge and processes to take financial control of their companies.

We help networks to gather and use financial and business information to establish a culture of profit management.

Our 'outsider's eyes' can provide fresh insights to supplement your expertise.

We can work with you on a single project or combine our suite of services to create a process that places profitability at the core of your business model.

And because we know franchising, we're committed to working with you to ensure your investment delivers a real return...**more profit, more cash and more value.**

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Seminars and workshops that give people the skills and confidence to manage for profit.

Financial information is only useful if you know how to interpret it and use it to make smart business decisions. Our seminars provide practical tools that answer questions like:

- How do I build value in my business?
- What are the key financial indicators to focus on?
- How can I use breakeven as a management tool?
- What drives my cash flow and how can I improve it?
- How should I manage debt and plan for expansion?

We work with you to customize our approach to your network's unique business environment and vernacular.

Performance profiles that transform financial and operational data into a powerful management tool.

We produce reports on network performance and customized assessments for franchisees that help spark conversations that matter. The reports typically examine:

- Cost, profit and productivity profile of your network
- Characteristics of the most successful franchisees
- Profiles for different revenue and market segments
- Financial strength and risk

Our clients use their profiles to review and develop strategy, and to identify opportunity to improve profit and cash.

Group coaching programs that harness the power of peer support as a foundation for success.

Well presented information and knowing what to do does not get the job done! Your investment to bring the knowledge to the people pays dividends when people take action.

We work with individuals and groups to create goals, share experience and create support structures that prompt accountability and performance improvement.

Clients use our programs to focus strategic planning, supplement and enhance field support and to inspire the actions that get results.

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About the author



Barbara Carper is the founder and president of Profit Soup. She combines the management and teaching skills of a seasoned business advisor with the technical knowledge of a CPA. She has worked with business owners and managers across the United States, Canada and Australia, providing them with practical tools and techniques to achieve greater control over the financial future of their companies. She is an experienced, skilled, and entertaining seminar presenter.

Ms. Carper has authored financial benchmark studies in numerous industries. She is also a frequent speaker at franchise and association conventions, delivering financial topics in a non-threatening, no-nonsense, naturally approachable style. Her clients include: WIN Home Inspection, Auntie Anne's Pretzel's, Home Instead Senior Care, Kwik Kopy in Canada and Australia, ProSource Wholesale Flooring, National Insulation Contractors' Exchange, the American Rental Association and the National Community Pharmacists Association (U.S.) to name a few. She is a frequent facilitator for industry peer group meetings and strategic planning sessions giving her a unique perspective of the long and short-term challenges that business owners, franchisees and franchisors face each day.