

Excerpt from

Franchise Value: Valuation Methods and Benchmarking Data



Franchise Value: Valuation Methods and Benchmarking Data

A BVR SPECIAL REPORT



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What It's Worth

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Introduction

Franchises are serious business!

Franchise businesses in the U.S. cover a broad range of industries—nearly 300, in fact—but the challenges they present to business appraisers are very similar. As of 2010, the U.S. Census Bureau estimated that franchise businesses accounted for 10.5% of businesses with paid employees. Of the 4.3 million establishments surveyed, over 450,000 were either franchisee or franchisor owned.

In 2010, the U.S. Census Bureau released the results of the 2007 Economic Census. This was the first time the census had counted franchise businesses other than restaurants, and it focused on the year 2007. Thus, contained within the census was a report on franchises in the U.S.

In the study, franchise businesses accounted for nearly \$1.3 trillion of the \$7.7 trillion in total sales for these industries and 7.9 million workers out of a workforce of 59 million.

Among franchise businesses, the Census Bureau says 77% are franchisee owned. Fast food restaurants had the highest number of franchise establishments, followed by gas stations with convenience stores and full-service restaurants. New car dealers led sales for franchises, followed by gas stations with convenience stores and fast food restaurants. Those three categories accounted for over \$900 billion in 2007.

How likely are you to run across a franchise in your valuation practice? With over 10% of all businesses in the U.S. being franchises, and more in some industries, the likelihood is substantial.

This report examining the myriad valuation challenges that a franchise operation agreement represents for valuation experts is based on a Business Valuation Resources webinar presented by

Theresa Zeidler-Shonat and Bill Pellino, both from Smith & Gesteland. It includes a vast amount of benchmarking data from the *Pratt's Stats* database, broken down by major industry. These data include financial metrics on income statements, selling price, valuation multiples, and operating ratios to help appraisers hit the mark when benchmarking the value of a franchise.

Chapter 1. Defining Franchises

The word “franchise” can mean the right to sell a company’s goods or services in a specific area, a business given that right, or the intangible assets consisting of that right when combined with the brand, business process, and other things that make that intangible recognizable.

Franchising itself is a way of organizing and developing a business. Most corporations are organized such that every location of a business is owned by the company and operated by its employees. In franchising, the ownership and operations of the location are distributed to franchisees who are independent business owners rather than employees of the corporation.

A franchisor is the overarching company that offers or awards franchises to franchisees. A franchisee, which can also be referred to as a franchise or a franchise business, is an individual or group of individuals or a corporation that is licensed to use the brand name, the logos, the business systems, products, and other services that the franchisor provides.

A franchisee is given this license for a renewable period, usually up to 20 years, although some are only 10 to 15 years.

Among franchise businesses at the time of the most recent census, 77.4% of the establishments were franchisee owned, which accounted for \$1.1 trillion in sales, about \$125 billion in annual payroll, and employment of nearly 6.3 million workers. The franchisor-owned businesses made up slightly less than 23% of franchise businesses and accounted for \$210 billion in sales.

Interestingly, in the used auto dealer industry, sales per establishment tended to be higher for franchise businesses than nonfranchise businesses. Franchise establishments in this industry reported sales per business of \$16.2 million versus \$2.5 million for the industry as a whole. That is a difference of \$13.7 million.



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