

# THE VALUE OF FRANCHISING

A REPORT FOR THE INTERNATIONAL  
FRANCHISE ASSOCIATION



SEPTEMBER 2021



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## SEPTEMBER 2021

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# EXECUTIVE SUMMARY

Franchising is an established business expansion strategy to help companies grow. Through a legal agreement, the franchisee sells a product or service using the brand name or operating system (or both) of the franchisor, typically in return for a lump sum payment and annual royalty fee. Most people immediately associate franchising with fast food restaurants. Interestingly, however, quick service restaurants are just a fraction of the entire sector, making up only a fourth of all franchised establishments, less than half of the workers, and just over a third of the economic output.

In commissioning this study, the International Franchise Association asked Oxford Economics to examine the value of the franchising model along a range of dimensions. We had three goals for this research:

- **Analyze pay, benefits, and training** at franchised firms and compare these attributes with similar non-franchise employers where possible.
- **Assess franchising as a path to entrepreneurship** and uncover areas where the business model provides vital support to prospective business owners.
- **Understand how franchisees are embedded in their local communities** by examining their supply chains and charitable giving.

## FRANCHISES OFFER PAY, BENEFITS, AND TRAINING ON PAR WITH COMPARABLE NON-FRANCHISE SMALL BUSINESSES

To see how wages at franchise firms stack up, we explore wage data from a sample of 3,700 franchise and 137,000 non-franchise small businesses, drawn from the Homebase payroll database. An econometric analysis of workers' wages controlling for a variety of factors finds that workers at franchise firms earn slightly higher wages (2.2-3.4%, corresponding to \$0.24-\$0.37 per hour at the sample mean wage of \$11 an hour) than workers at non-franchise firms, although this difference is only statistically significant in some specifications. Franchise firms in our dataset are somewhat larger on average (13.6 versus 9.6 distinct workers per month), in line with results from the U.S. Census Bureau's most recently released 2016 Annual Survey of Entrepreneurs (ASE).

An analysis of newly hired workers in the Homebase data also finds that starting wages, wage growth, and worker turnover are extremely close between franchises and non-franchises. Franchise workers were promoted to manager status at slightly higher rates than non-franchise workers (14% vs. 11% after 20 months), although this difference was of marginal statistical significance ( $p=0.065$ ).

In addition to the payroll database, we look at fringe benefits using a survey of franchisees completed by over 4,000 respondents (hereafter referred to as the franchise census). We find that the share of workers that is offered various types of benefits at small franchised firms is roughly on a par with the share of employees with access to those benefits at small U.S. establishments.

Franchises also appear to offer training to a very similar extent to the average U.S. business. According to the Association for Talent Development, in 2019 each U.S. employee used 34.7 hours of formal learning on average. The franchise census suggests franchisees offer an average of 33.4 hours of formal training per employee, with 11% of respondents offering 50 hours or more per worker.

## **FRANCHISING OFFERS A PATH TO ENTREPRENEURSHIP TO ALL AMERICANS, BUT ESPECIALLY TO NEW ENTREPRENEURS AND WOMEN**

The 2016 Annual Survey of Entrepreneurs suggests that franchise businesses tend to be larger than non-franchise businesses. We find that, on average, franchises report sales 1.8 times as large and provide 2.3 times as many jobs as non-franchise businesses. Sales and jobs in franchised businesses exceed non-franchised businesses across all demographic cuts, including gender and race. For example, Black-owned franchise firms generate 2.2 times as much in sales compared to Black-owned non-franchise businesses, on average.

What factors enable franchised businesses to reach a larger scale? The franchise census asks franchisees to describe the areas where franchisor support was received and proved most useful. Results suggest the important areas are franchisee training, meetings and events, and technology platforms. Even in areas where franchisor support is less widespread, such as access to capital support (received by 42% of respondents), the positive effects of the business model are striking. Some 21% of respondents report being capital constrained when starting their first franchise business and that being a franchisee provided them with access to capital.

In addition, 32% of all respondents report they would not own a business if they were not franchisees. This proportion is even greater among both female owners and owners for whom a franchise was their first business (39%). When applied to the total number of franchise firms from the 2016 ASE, this would be equivalent to a loss of 60,000 businesses (or nearly 223,000 establishments, employing some 1.8 million workers) if franchising was not an option.

## **FRANCHISES ARE LOCALLY OWNED AND THIS KEEPS RESOURCES IN THE LOCAL COMMUNITY**

Unlike the multi-unit company-owned business model, franchises allow local franchisees to buy and own the units they operate. By doing so, franchisees become small business owners, who live and work in their local communities. The brands they represent largely recruit and train local residents rather than bringing in workers from other parts of the country. The franchise model therefore encourages local employment and wealth-sharing with local communities.

The franchise census suggests franchisees purchase 21% of their inputs from local suppliers, indirectly contributing to their local economies through their supply chains. Over a third of respondents (36%) purchase at least 25% of their intermediate goods locally.



In addition, some 65% of franchisees give to local charities according to the franchise census. This is in line with findings that suggest 66% of all small businesses do so. Among donors, franchisees donate an average of 6% of their profits (also in line with small businesses' data). We estimate that U.S.-based companies operating as franchises jointly donated a total of \$1.5 billion to charity in the year before the pandemic and raised over \$900 million over the same period. Some 18 million hours of volunteering were sponsored by franchised businesses in 2019, which are worth hundreds of millions of dollars to society more broadly.

In conclusion, this study finds that franchises offer wages, benefits, and training on par with similar non-franchise small companies. We also show that franchising offers a path to entrepreneurship to all Americans, but particularly to first-time owners and women. Lastly, we highlight how franchisees are embedded in their local communities through their local supply chains and charitable giving.

# 1. INTRODUCTION

By myriad measures of economic output, franchising represents one of the most dynamic and widely used business growth strategies. Through a legal agreement, the franchisee sells a product or service using the brand name or operating system (or both) of the franchisor, typically in return for a lump sum payment and annual royalty fee.<sup>1</sup> The rationale behind the business model is that product's or service's image, marketing, and basic operating practices are created most efficiently in large scale by the franchisor, while the actual production of the goods and services is most efficient when it is decentralized to the place of consumption.<sup>2</sup>

Franchising is an important aspect of the U.S. economy. In 2019, the economic output of franchise establishments in the United States was about \$787.5 billion and represented 3% of the total Gross Domestic Product (GDP). Contributing to this activity were about 8.4 million people who worked for a franchise business.<sup>3</sup>

This report, commissioned by the International Franchise Association, analyzes the role that franchising plays in the U.S. economy. It provides a first-of-its-kind assessment of the value of the franchise business model to workers, entrepreneurs, and local communities. Our principal data source is a survey of franchisees completed by over 4,000 respondents (hereafter referred to as the franchise census).

Fieldwork for the survey took place between April and May 2021, but most questions referred to the year preceding the COVID-19 pandemic in the U.S., and so paint a picture of franchising perspectives before the pandemic struck. The survey explores the benefits and training offered at franchised firms, the key areas where the business model provides support to prospective business owners, and the degree of local procurement and charitable giving, among other things.

The report is structured as follows: Section 2 looks at the uses of franchising from the franchisor's perspective. Section 3 provides insights into franchise businesses as employers of U.S. workers, looking at both wage and non-wage compensation. Section 4 explores the role of franchising as a path to entrepreneurship, including an analysis of the core areas of support provided to franchisees by franchisors. Finally, Section 5 explores the importance of franchisees as contributors to their local economies.



***Being part of a franchise has been invaluable to me. Working with the corporate office, as well as the other owners, has been such a gigantic help in all aspects of the business. I am so happy I bought a franchise***

**Franchise census respondent**

<sup>1</sup> Scott A. Shane, "Hybrid Organizational Arrangements and Their Implications for Firm Growth and Survival," *Academy of Management Journal*, 39(1) (1996): 216-34.

<sup>2</sup> Paul H. Rubin, "The Theory of the Firm and the Structure of the Franchise Contract," *Journal of Law and Economics*, 21(1) (1978): 223-33. Richard Caves and William Murphy, "Franchising: Firms, Markets, and Intangible Assets," *Southern Economic Journal*, 42(4) (1976): 572-86.

<sup>3</sup> FRANdata, "International Franchise Association Economic Outlook for Franchising," 2021.

# 2. USES OF FRANCHISING

## 2.1 WHY BRANDS FRANCHISE

Scholars tend to agree that franchising mostly arises to lower a company's monitoring costs, what economists refer to as the **principal-agent problem**. By collaborating with their franchisees, franchisors (the principal) are able to ensure that the manager of the local establishment (the agent) has a strong incentive to make that establishment profitable, because he or she is the owner of that establishment. No salaried manager will ever care as much as an owner about the profitability of that business.

The nature of most franchised businesses is such that there are numerous, geographically dispersed production centers.<sup>4</sup> Geographic dispersion creates special monitoring problems for the firm. Brickley and Dark (1987) find that the cost of monitoring store managers appears to be especially important in the own/franchise decision.<sup>5</sup>

Another key driver for franchising is to achieve **economies of scale**. Since franchising allows firms to grow their businesses at relatively little direct capital expense, firms use this organizational structure to scale their business models.<sup>6</sup> By expanding their businesses through franchising, firms are able to increase product volume and thus enhance bargaining power, which better promotes economies of scale than a purely company-owned structure. In the end, firms that are highly involved in franchising can achieve greater efficiency than those with lower or no involvement in franchising.

In addition, franchising allows firms to better **adapt to diverse environments**; Sorenson and Sørensen (2001) find that, under the relatively similar environments within a single state, franchised restaurant chains perform best when they franchise roughly 20% of their establishments.<sup>7</sup> As they expand geographically and face more diverse markets, the ideal portfolio of governance structures shifts. Chains operating in all 50 states function best when they franchise around 70% of their units.

Today, franchising is used by a wide range of both new and well-known brands throughout the business lifespan, with about half of franchised brands owning more than 25 establishments, and about half owning fewer (Fig. 1). While established brands are unlikely to experience **limited access to capital markets**, a theory by Oxenfeldt and Kelly (1968) argues that “franchisors create systems

<sup>4</sup> Robert E. Martin, “Franchising and Risk Management,” *The American Economic Review*, 78(5) (1988): 954-68.

<sup>5</sup> James A. Brickley and Frederick H. Dark, “The choice of organizational form: The case of franchising,” *Journal of Financial Economics*, 18(2) (1987): 401-20.

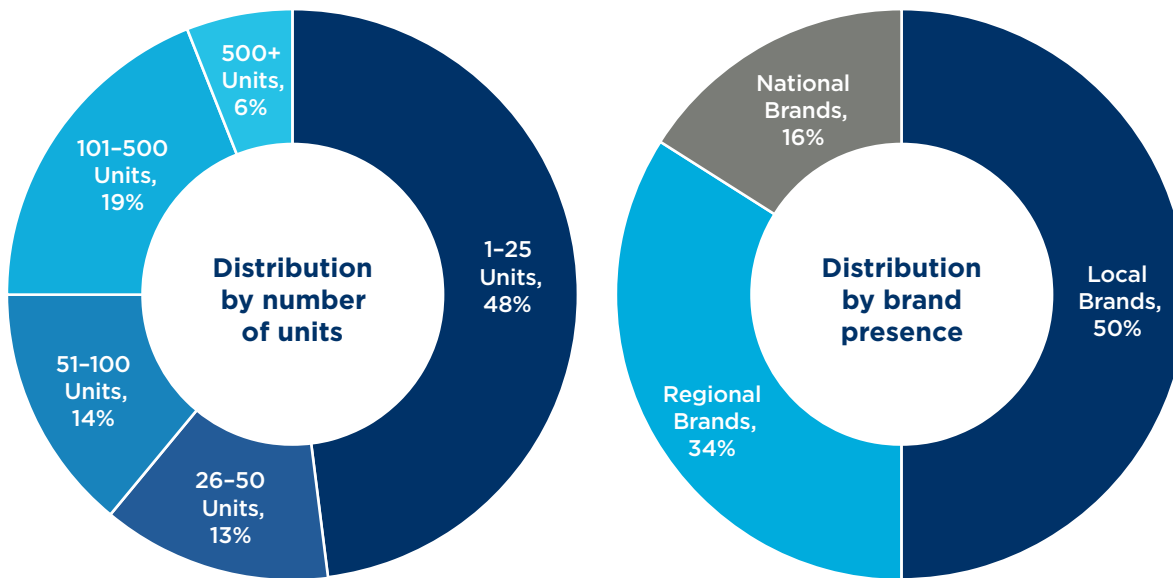
<sup>6</sup> Kyung-A Sun and Seoki Lee, “Competitive advantages of franchising firms and the moderating role of organizational characteristics: Evidence from the restaurant industry,” *International Journal of Hospitality Management*, 77 (2019): 281-9.

<sup>7</sup> Olav Sorenson and Jesper B. Sørensen, “Finding the Right Mix: Franchising, Organizational Learning, and Chain Performance,” *Strategic Management Journal*, 22 (2001): 713-24.



because they have too little capital to create a wholly owned chain” (resource acquisition theory).<sup>8</sup> More recent evidence instead suggests that the likelihood of franchising decreases as per-unit capital requirements increase, in contrast to the capital-constraint arguments for franchising.<sup>9</sup> The very fact that franchising remains widespread among large and highly successful brands points to the fact that this theory may not hold over the entire business life cycle.

**Fig. 1. Franchise brand distribution by number of units and brand presence**



Source: FRANdata

Even one of the harshest critics of franchising acknowledges some of its benefits.<sup>10</sup> Weil (2014) writes that “franchising provides a mechanism for a lead company to create a model of business organization that can be replicated by others but controlled by a lead company. It creates a mutually advantageous means of sharing the gains of a brand, as well as an ingenious mechanism to push out the difficult task of providing the good or service to other entities with greater incentive to control costs while still selling the product of the lead company.”

Weil’s central thesis is that today’s labor markets are characterized by a “fissured workplace” in which employers shed non-core employees in order to reduce wages. According to the author, this happens because the cost of non-core functions, particularly low skill, labor intensive ones, is determined via price setting in a market for services rather than a wage setting exercise. According to Weil, franchising uses fissured employment to lower labor costs, thereby leading to the proliferation of fissured workplaces.

<sup>8</sup> Alfred R. Oxenfeldt and Kelly, Anthony O., “Will successful franchise systems ultimately become wholly-owned chains?,” *Journal of Retailing*, 44 (1968): 69-83.

<sup>9</sup> James A. Brickley, Frederick H. Dark and Michael S. Weisbach, “An Agency Perspective on Franchising,” *Financial Management*, 20(1) (1991): 27-35.

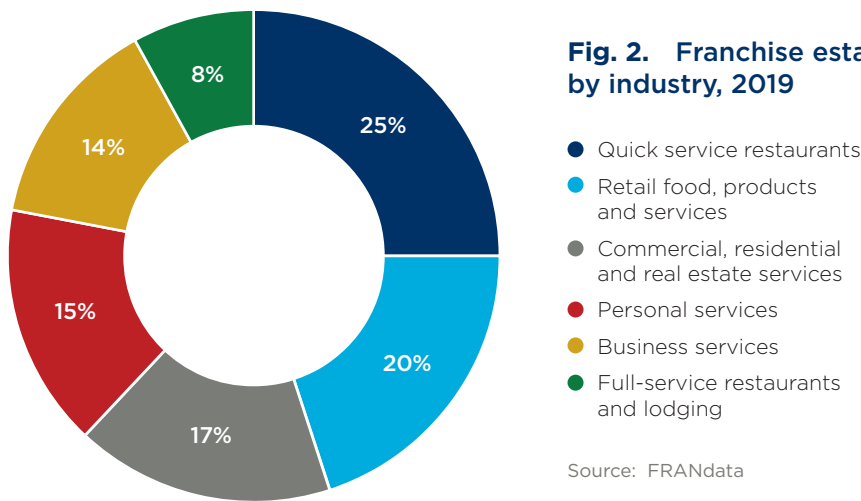
<sup>10</sup> David Weil is Dean and Professor at Brandeis University’s Heller School of Social Policy and Management and is the author of the book David Weil, *The Fissured Workplace* ([n.p]: Harvard University Press, 2014).

The problem is that Weil mixes franchising with other practices, such as contracting (and subcontracting) non-core tasks. While there are certainly cases in which companies combine a range of organizational practices in order to lower labor costs, **it is far from clear that franchising per se lowers salaries.** In particular, as shown in Chapter 3, analysis of Homebase data suggests that there are no significant differences between wage rates at small franchised and non-franchised establishments.

## 2.2 FRANCHISING IN THE U.S.

Most people immediately associate franchising with fast food restaurants. Interestingly, however, quick service restaurants (QSR) are only a fraction of the franchising ecosystem, making up only a fourth of all franchised establishments, less than half of the workers, and just over a third of the economic output (Fig. 2). Franchise businesses operate in over 300 business lines, including amusement parks, automotive, business-to-business services, cell phone repair, fitness, hair care, home repair services, tutoring, spas, childcare, pet care, and senior care.

The retail sector is another major user of the franchise business model, encompassing about one in five franchise establishments. This sector is less labor intensive than QSR, which explains why the sector only supports 13% of all franchise jobs. Similar features apply to franchise personal services, which constitute 15% of all franchise establishments, but only 6% of franchise jobs. On the other hand, full-service restaurants and lodging employ 21% all franchise workers, but only make up 8% of all franchise establishments.



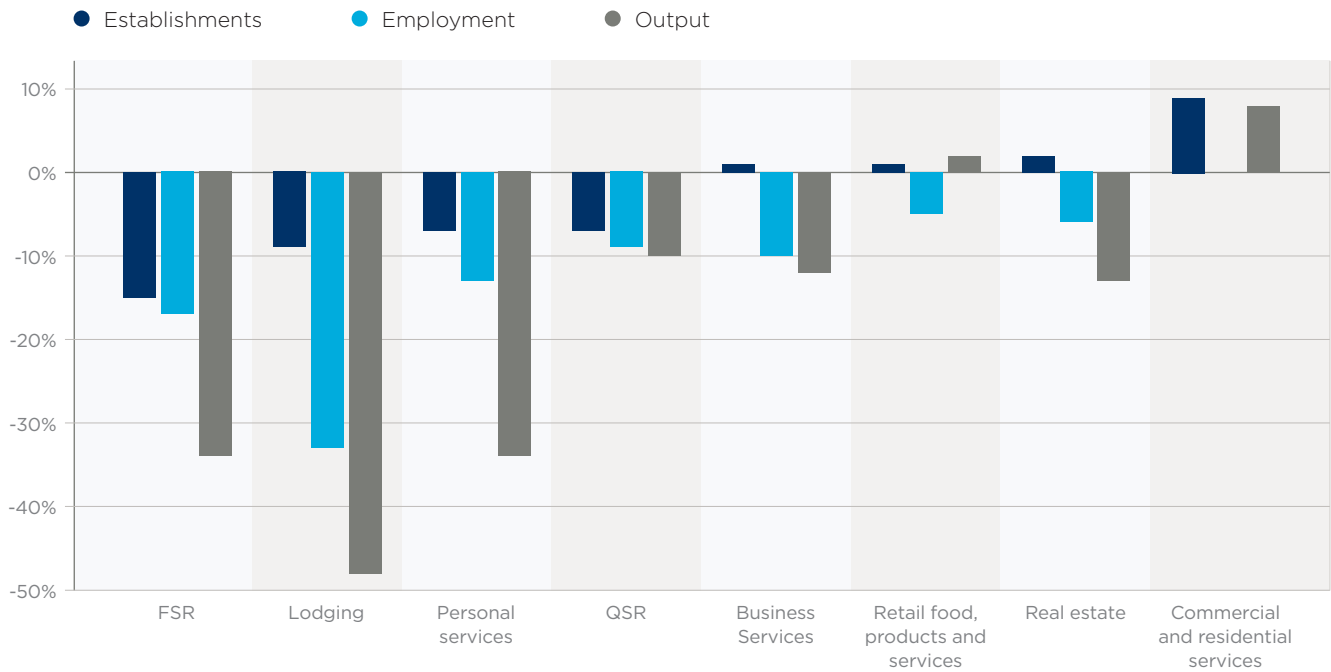
**Fig. 2. Franchise establishments by industry, 2019**

- Quick service restaurants
- Retail food, products and services
- Commercial, residential and real estate services
- Personal services
- Business services
- Full-service restaurants and lodging

Source: FRANdata

The data described so far illustrate the industry composition in 2019. The pandemic has created winners and losers because of evolving consumer preferences, current economic conditions, and government regulations. Some sectors have benefited from the changes, especially in the commercial and residential services, and retail food, products, and services sectors (Fig. 3). Still, some sectors suffered devastating losses, including lodging, personal services, and table/full-service restaurants (FSR). Even QSR, despite their reputation of being recession-proof, suffered significantly during the pandemic.

**Fig. 3. Change in franchise establishments, jobs, and output, 2019-20**



Source: FRANdata

# 3. FRANCHISEES AS EMPLOYERS

Research indicates that franchises in general are more sophisticated in their organizational practices than comparable non-franchise operations, which might suggest that their workplace practices would also be more sophisticated. On the other hand, franchise jobs are often caricatured as having high turnover, low investment in training, and little encouragement of employee involvement. Findings largely depend on the control group researchers choose to compare franchises against.

The most relevant control group for franchisee-owned outlets is local independent businesses because franchisees own their units and are therefore alike any other entrepreneur. Some studies, however, do compare the practices of franchisee-owned to company-owned units (see Krueger, 1991, among others).<sup>11</sup>

The academic literature is therefore divided into two main streams: Cappelli and Hamori (among others) are interested in the comparison *between* franchise and independent businesses, while Krueger (among others) focuses on ownership status *within* franchise companies and use company-owned establishments as the control group.<sup>12</sup>

While both approaches address important research questions, the former appears better suited to determine the merits and characteristics of franchisees as employers. In keeping with this, in section 3.2 we follow Cappelli and Hamori (2008) and compare wages and career progression at franchisees vis-a-vis small independent businesses.

## 3.1 THE LITERATURE

Research by Cappelli and Hamori (2008) suggests that franchises' employee management practices tend to be more advanced than those of equivalent independent operators. The authors use data from a sample of establishments in the mid-1990s to examine the relationship between franchise status and employment practices. They find that, once industry, size, and other control variables are included in the analysis, franchises tend to offer similar jobs and were more likely to employ high quality management practices than did similar non-franchise operations.

In particular, the authors find that **there are no statistically significant differences with respect to pay or benefits for franchises**; the signs of the variables actually point toward higher pay and benefits for franchises. The results



*For young workers especially, the things you can learn on [“menial”] jobs—responsibility, cooperation, punctuality—can be lifelong assets in many other occupations.*

Sowell (1987)

<sup>11</sup> Alan B. Krueger, “Ownership, Agency, and Wages: An Examination of Franchising in the Fast Food,” *The Quarterly Journal of Economics*, 106(1) (1991): 75-101.

<sup>12</sup> Peter Cappelli and Monika Hamori, “Are Franchises Bad Employers?,” *Industrial and Labor Relations Review*, 61(2) (2008).

for training are consistent with the idea that franchises provide more extensive and intensive formal training to their employees than do non-franchise operations. Franchise operations were more likely to have a formal training policy, trained a significantly higher percentage of their non-managerial work force, and provided more training hours per employee. And overall, labor costs per employee were higher in franchise operations. There is therefore no support in their study for the idea that franchises pursue a strategy of lower expenditures on employees. Franchises also appear to make greater use of work organization practices associated with employee involvement, such as work-related meetings and TQM (total quality management) practices.

Among the studies that use company-owned establishments as a control group, an insightful analysis is the 1991 paper by Alan Krueger examining wage rates for line workers and shift supervisors at franchised and company-owned fast-food restaurants.<sup>13</sup> Krueger found a very **small difference in the wage rates for nonmanagement workers at franchised versus company-owned stores.**

“Full-time workers earn 1.7% greater wages at company-owned restaurants... for part-time workers the company-ownership differential is just 0.5%. Although these coefficients are precisely estimated, they are trivial by most economic standards.”

In contrast with this literature, in his book “The Fissured Workplace,” Weil argues that employers have an incentive to shed all non-core employees in order to reduce wages. While there are certainly instances in which firms combine a variety of organizational practices in order to reduce labor costs, it is far from obvious that franchising per se reduces wages, as shown in this chapter.

Similarly, in his 2015 work with Ji published in the ILR Review, Weil studies the differences in compliance with federal minimum wage and overtime standards in the fast-food industry between franchised and company-owned establishments.<sup>14</sup> The authors find that franchised outlets have higher levels of noncompliance than comparable company-owned establishments. Neither this article, nor other studies, however, compare violations of franchised relative to small independent businesses, a more natural comparison. There is therefore no evidence that franchised businesses have more compliance issues than other similarly situated small businesses.

## 3.2 THE DATA

### 3.2.1 A fresh look at franchise wages using Homebase

With the Cappelli and Hamori analysis now more than 20 years old, we set out to undertake a similar wage comparison between franchises and non-franchises in a regression framework using Homebase data. Homebase started making its data public in March 2020 as a tool to track the impact of the COVID-19 pandemic and

<sup>13</sup> Alan B. Krueger, “Ownership, Agency, and Wages: An Examination of Franchising in the Fast Food,” *The Quarterly Journal of Economics*, 106(1) (1991): 75-101.

<sup>14</sup> MinWoong Ji and David Weil, “The Impact of Franchising on Labor Standards Compliance,” *ILR Review*, 68(5) (2015): 977-1006.

proved to accurately predict the monthly job reports on multiple occasions. As a consequence, major economists of the caliber of Harvard professor Raj Chetty started using the dataset to forecast labor market outcomes, but also more generally to test employment and earnings hypotheses.

Homebase provides scheduling tools for small businesses (on average, firms in our sample have 9.7 distinct workers in a given month) such as restaurants (50% of companies for whom sectoral data are available) and retail stores (19% of companies for whom sectoral data are available). The industry composition of the dataset is a major advantage for answering our research question, given its similarity with the franchisee population.

Homebase provides a complete roster of workers at a given firm, but largely covers workers at small businesses, because these are the businesses most likely to use this low-cost payroll software. While this might be considered a limitation of this dataset, our analysis is mainly interested in franchisee-owned outlets, which are more likely to be small on a per establishment basis. For this reason, we consider the small business focus of Homebase as an additional strength of these data. For similar reasons, we believe our franchise sample is almost entirely franchisee-owned rather than corporate-owned.

Lastly, as suggested by Chetty et al, (2020), Homebase provides statistics that may be representative of low-wage (bottom-quintile) workers, which once again are the key workers our analysis is interested in.<sup>15</sup> For all these reasons, we conclude Homebase is an excellent data source for an analysis of how franchise wages differ from those at non-franchise businesses, the core research question and empirical contribution of this report.

We obtain anonymized individual-level data on hours worked and wages earned for employees at firms that utilize Homebase payroll as hour-keeping software. Our sample runs from January 1, 2018 through December 31, 2019 and includes more than 141,000 companies.<sup>16</sup> We then hand-matched Homebase company names with a list of franchise brands and some 3,700 (2.6%) companies were identified as franchises. According to the 2016 Annual Survey of Entrepreneurs, 3.4% of U.S. firms is fully or partly operated as a franchise, so the 2.6% share in the Homebase dataset is reasonably close. Details about the Homebase data and analysis, including summary statistics, are presented in the Appendix.

## WAGE COMPARISON

Overall, wages for franchise and non-franchise firms in the Homebase data are very similar. In the Appendix, we present the results of three econometric regression specifications run on the entire Homebase sample, as well as a smaller sample of heavy Homebase users with higher quality data. In these models, we control for manager and full-time status, company size, time, industry, and county dummies. Overall, our regressions show that franchise firms pay 2.2-3.4% higher wages than similar non-franchises, although these results are only statistically significant

<sup>15</sup> Raj Chetty, John N. Friedman, Nathaniel Hendren, Michael Stepner, and the Opportunity Insights Team, "Real-Time Economics: A New Platform to Track the Impacts of COVID-19 on People, Businesses, and Communities Using Private Sector Data," 7 May 2020.

<sup>16</sup> Our sample ends in 2019 in part to avoid complications from Covid-19.



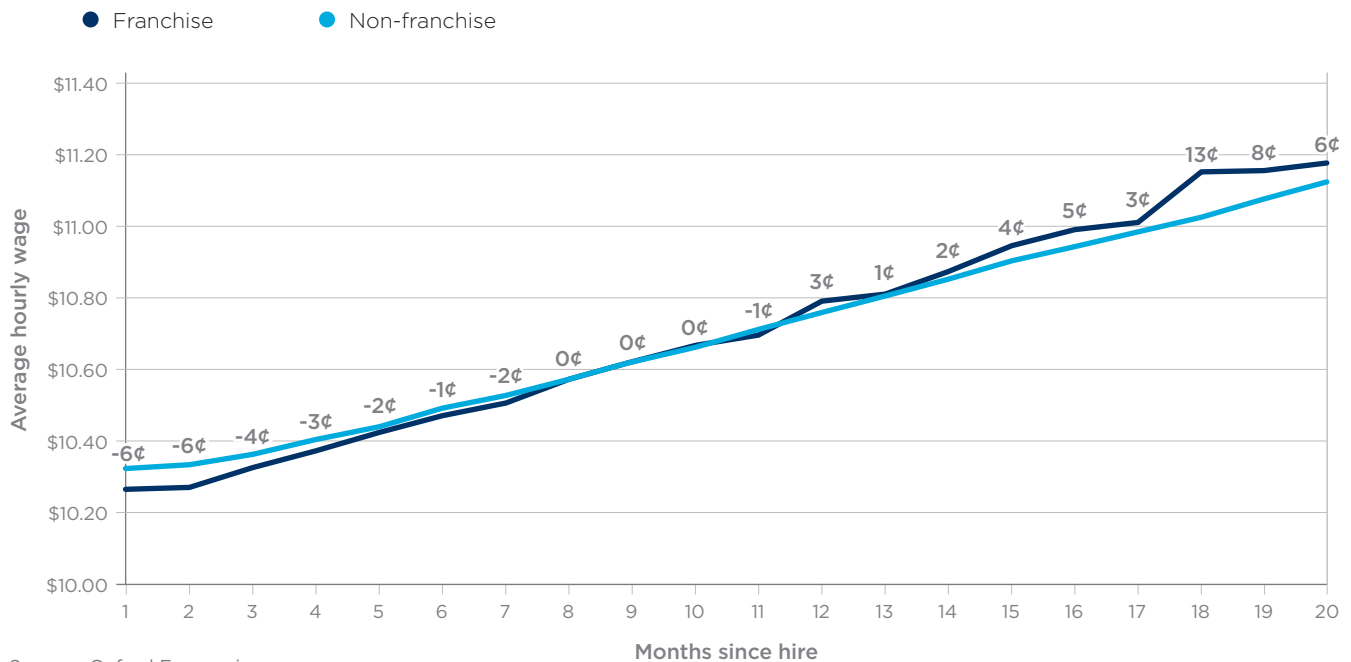
in some of the regressions. With a mean wage of \$10.84 in our sample, this corresponds to \$0.24-\$0.37 more per hour for an average worker in this sample.<sup>17</sup>

### NEW WORKERS

In order to obtain a balanced sample on worker characteristics, we examine new hires and then follow their wage progression month-by-month. Note that for this analysis, in order to better identify workers who are new to their employers rather than firms that might be using the Homebase system inconsistently, we focus on a subsample of businesses enrolled in Homebase for 24 consecutive months.

In Fig. 4, we show the average wage of newly hired workers at franchise and non-franchise firms respectively, labeled with the difference between franchise and non-franchise wages. As shown in this figure, workers at franchises earned slightly less (\$0.06 per hour) than workers at non-franchises in their first month on the job. Over time, pay increased for both franchise and non-franchise workers, but slightly faster for franchise workers, reaching parity by month eight, and exceeding non-franchise wages by \$0.06 per hour after 20 months. Overall, these results are consistent with the regression results above showing that wages at franchise and non-franchise firms are very similar.

**Fig. 4. Average wage of newly hired workers at franchise vs non-franchise companies labelled with difference between franchises and non-franchises**



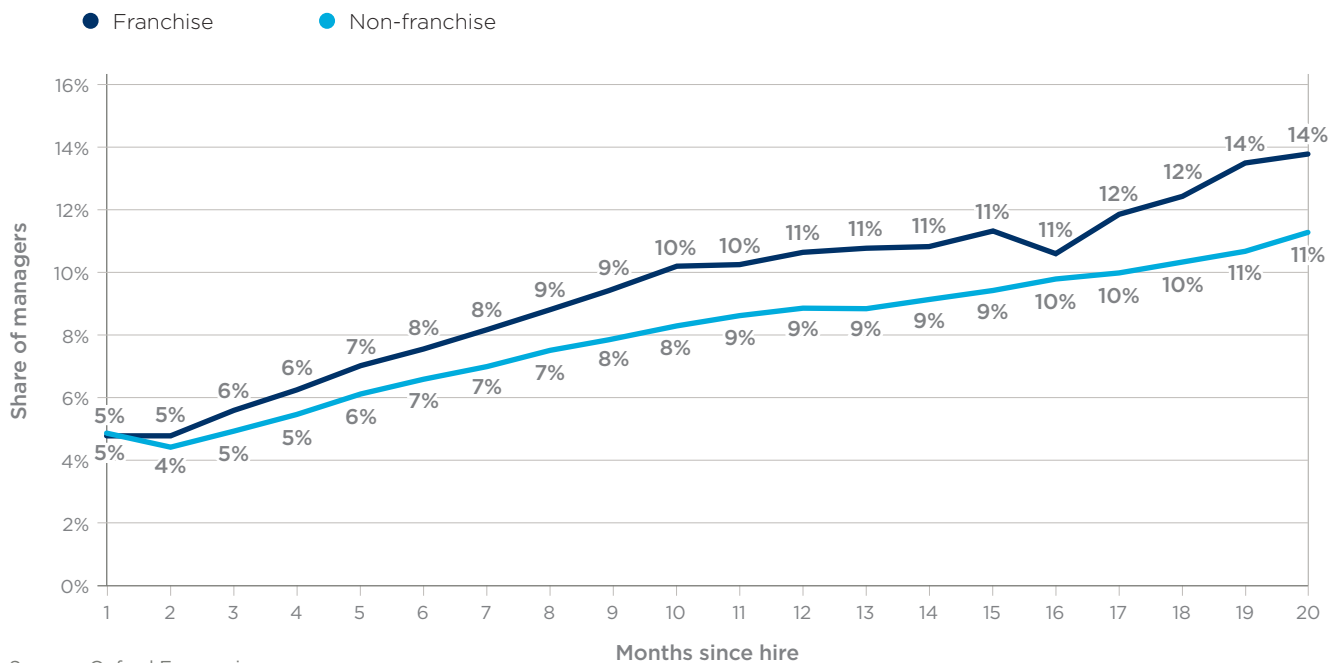
Source: Oxford Economics

<sup>17</sup> A limitation of the Homebase data is the lack of most worker-level information typically included in studies on workers' wages, including age, race, sex, education, and experience. Thus, the small positive effect of working at a franchise firm observed in the regression analysis described above could be biased if workers at franchise and non-franchise firms systematically differ in these unobserved characteristics. It should be noted, however, that even the Cappelli and Hamori paper did not account for workers' demographic characteristics for similar reasons.

Other comparisons between franchise and non-franchise workers are also very similar. In particular, the retention rates of franchise and non-franchise firms (i.e., the share of the initial workers hired remaining with the employer in each successive month) never differ by more than 2 percentage points. An important implication of these similar retention rates is that differences in salary and manager status are not the result of franchises (or non-franchises) shedding subgroups of workers at much higher rates.

One area where franchises and non-franchises did differ was in the share of newly hired workers who eventually achieved manager status. Fig. 5 shows the share of newly hired workers remaining at their company who achieved manager status within 20 months. While the share is almost identical at franchises and non-franchises in the first month of employment (5% each), that share widened consistently over time, reaching 14% of remaining workers at franchises after 20 months but only 11% at non-franchises ( $p=0.065$ ).

**Fig. 5. Share of remaining workers who were managers with difference between franchise and non-franchise retention**



Source: Oxford Economics

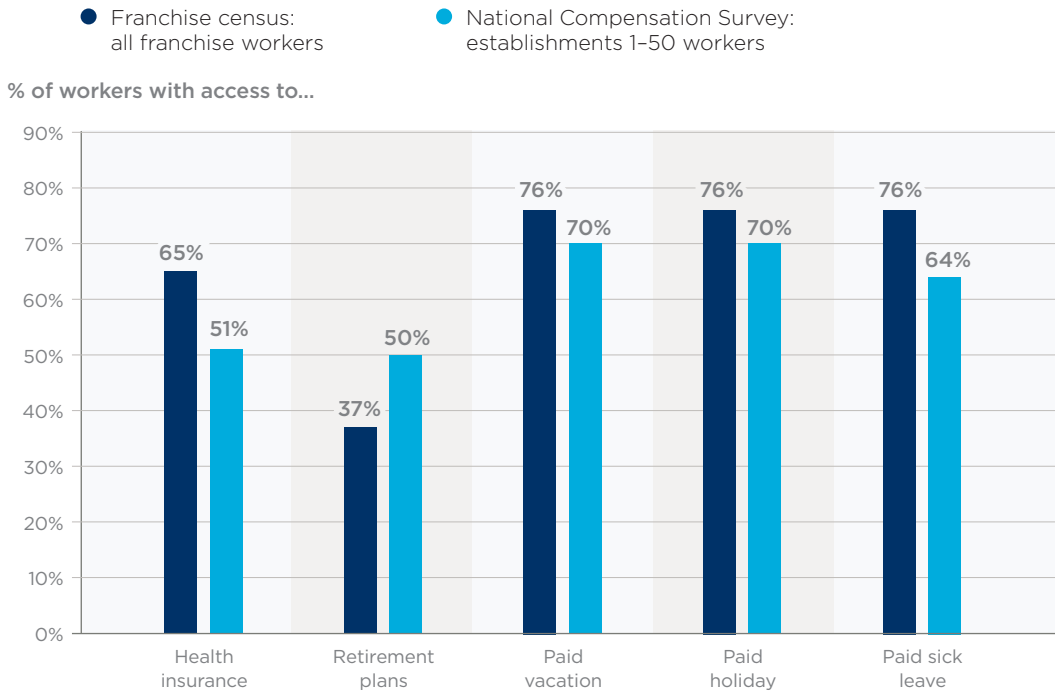
Overall, the Homebase data show that franchises in our sample pay very similar wages to similar non-franchise firms that choose to use the Homebase payroll software.

### 3.2.2 Non-wage compensation

Job quality is not about salary alone; benefits are another very important area workers consider before applying for or accepting a job. The bread and butter of a good benefits package is health insurance. In a spring 2021 survey of franchisees (the franchise census), more than 65% of franchise workers are offered health insurance (Fig. 6).<sup>18</sup> This is a very large proportion, especially when compared with the coverage rates at small establishments from the 2019 National Compensation Survey (NCS).<sup>19</sup>

Workers at franchises are less likely to receive retirement benefits than small establishments in the general business population (37% vs 50% of workers covered), but they are more likely to receive paid vacation, holiday, and sick leave. Some 76% of the workers at franchise establishments are offered paid leave policies, which compares with 64-70% in the general population of small establishments.

**Fig. 6. Proportion of workers with access to benefits, franchise vs non-franchise (small establishments)<sup>20</sup>**



Source: Franchise census, NCS, Oxford Economics

<sup>18</sup> Further details on the composition of the franchise census sample and weighting process can be found in the Appendix.

<sup>19</sup> It should be noted that the sample of franchisees we surveyed is mostly made up of small companies. Some 96% report an average establishment size of 50 workers or less, which is why we have selected workers at establishments with 50 or fewer employees as our benchmark from the NCS in Fig. 6.

<sup>20</sup> The analysis of the benefits data required a multi-step weighting process. We first estimated firm-level weights to match the franchise census sample with the franchise population distribution from the ASE (more details in the Appendix). We then used these weights to determine the weighted employment of each respondent. Lastly, we used each respondent's answer to the benefit question to assess the overall share of workers that is assumed to be covered, accounting for each respondent's part-time/full-time workforce composition.

Above and beyond competitive salaries and benefits, training courses are another tool to attract productive and ambitious workers. By attending training courses, employees develop skill sets that allow them to undertake a greater variety of work, both at the company itself, and also later in their careers. Training can also make workplaces safer, reducing the probability of accidents.

According to the Association for Talent Development (ATD) 2020 State of the Industry report, the average U.S. worker received 34.7 hours of formal learning in 2019. Our survey of franchisees finds that respondents offered an average of 33.4 hours of formal training per employee in the same year, suggesting franchisees offer training opportunities that are in line with the average U.S. company.<sup>21</sup> When looking at the distribution of the responses, we find that 11% of surveyed franchisees offered 50 hours or more of training in that year to each employee.



*The training for each job is very complete, so that no one feels unprepared when they begin.*

Franchise census  
respondent

<sup>21</sup> This was estimated by dividing the total number of hours of formal learning offered by the number of workers.

# 4. FRANCHISEES AS ENTREPRENEURS

One undervalued aspect of franchising is its role as an enabler of entrepreneurship. Certainly, franchisees have an entrepreneurial outlook. “From the individual franchisee’s perspective, a franchise is a new venture and therefore [he or she] can be considered an entrepreneur,” says a thought leader within the entrepreneurship field interviewed by Ketchen et al.<sup>22</sup> “They do almost all functions as other entrepreneurs except that they do not need to come up with the business idea,” says another.

And at least one major funder of small businesses sees franchisees as entrepreneurs: they can apply for loans from the U.S. Small Business Administration, a common financing option for both new franchisees and independent entrepreneurs.

This section reviews the core reasons for aspiring business owners to become franchisees; highlights some socio-demographic characteristics that are associated with the likelihood of franchising; and evaluates franchising survival and growth. The second half of this chapter draws from secondary sources and the franchise census to highlight key findings on franchising as a path to entrepreneurship.

“

*Without the support and backing of a franchise, we would have never attempted to open the business we are in.*

Franchise census respondent

## 4.1 THE LITERATURE

### 4.1.1 Why franchisees franchise

In section 2.1, we have highlighted some of the reasons why brands choose to franchise. Equally important for the success of the franchise business model is understanding what drives franchisees towards franchising, or in other words what transforms aspiring business owners into franchisees. Theory suggests that entrepreneurs will choose to franchise rather than establish an independently owned business if the expected utility from franchising exceeds the expected utility from independent business ownership.

Ghantous and Christodoulides (2020) offer a comprehensive view of **brand benefits** for franchisees.<sup>23</sup> Among these, they note economic benefits (strong brands attract consumers, allow franchisees to save on procurement, marketing, and brand building and management costs, and facilitate the sale of franchised outlets and increase their resale value), managerial benefits (providing specialized managerial capabilities that many independent entrepreneurs might lack), brand awareness and image (which signal the network’s quality), and relationship benefits (reducing franchisees’ perceived risk and facilitating relationships with other stakeholders).

“

*The benefit of national branding and support from corporate office and other franchisees is invaluable.*

Franchise census respondent

<sup>22</sup> David J. Ketchen, Jr., Jeremy C. Short, James G. Combs, “Is Franchising Entrepreneurship? Yes, No, and Maybe So,” *Entrepreneurship Theory and Practice*, 35(3) (2011): 583-93.

<sup>23</sup> Nabil Ghantous and George Christodoulides, “Franchising brand benefits: An integrative perspective,” *Industrial Marketing Management*, 91 (2020): 442-54.

Bronson and Morgan (1998) also show that **economies of scale** account for increased efficiency of franchisees over independent businesses, suggesting this as a motivating driver for franchising for both franchisors and franchisees.<sup>24</sup> Namely, franchisees have more buying power and scale/scope economy advantages over independent businesses.

Williams (1999) also finds that entrepreneurs are more likely to franchise than to start an independent business if industry risks are greater.<sup>25</sup> When starting a new business, profits and revenues are uncertain. Independent business owners bear all the risks associated with such uncertainty. The royalty percentage in the franchise contract, instead, facilitates **risk-sharing** between the franchisor and franchisee.

By accepting part of their compensation in the form of a royalty fee (calculated as a share of sales), franchisors bear a portion of the variation in the cash flows of individual franchise units, thereby reducing the risk borne by franchisees. Holding all else constant, the royalty fee rises or falls with economic conditions, meaning the franchisee's good times are "less good" than non-franchised businesses' good times, while bad times are "less bad" than non-franchised businesses' bad times. In contrast, the entrepreneur bears all risks as the sole owner of an independent business.

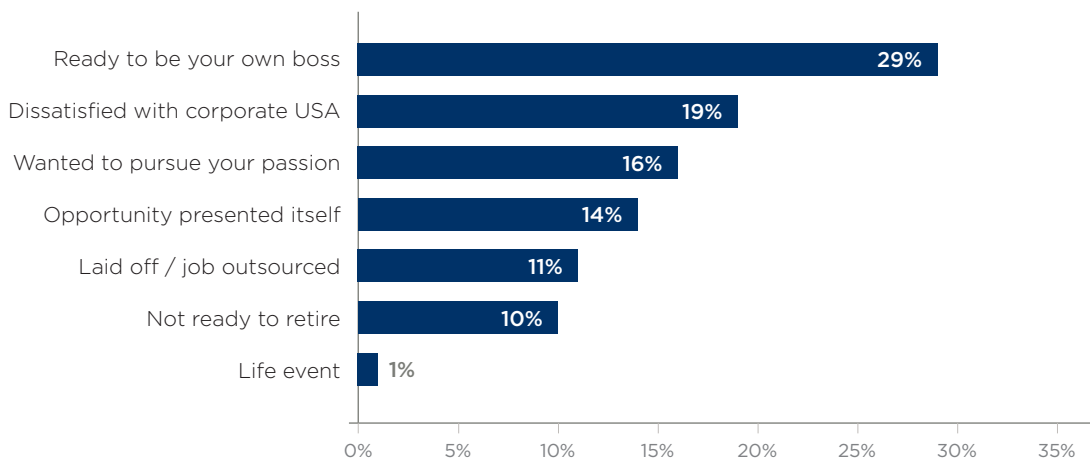
While theory suggests a host of reasons to choose franchising, 29% of franchise owners reported choosing to start/buy a franchise because they were ready to be their own boss, according to a survey by Guidant Financial (Fig. 7). For 19% of the respondents, dissatisfaction with the corporate world was the main reason to go into a franchise. A desire to pursue a passion was the third most common reason franchise owners gave for starting their franchise location, at 16%. Most of these are also among the key motivations for starting a business in general.<sup>26</sup>



*Being a franchisee has helped me realize my dream of being a business owning entrepreneur. There is no question that the franchise model has allowed me to develop personally and professionally.*

Franchise census respondent

**Fig. 7. Motivation for opening a franchise**



Source: Guidant Financial

<sup>24</sup> James W. Bronson and Cyril P. Morgan, "The role of scale in franchise success: Evidence from the travel industry," *Journal of Small Business Management*, 26(4) (1998): 33-42.

<sup>25</sup> Darrell L. Williams, "Why do entrepreneurs become franchisees? an empirical analysis of organizational choice," *Journal of Business Venturing*, 14(1) (1999): 103-24.

<sup>26</sup> Erik Hurst and Benjamin Pugsley, "What Do Small Businesses Do?," *Brookings Papers on Economic Activity*, 2011.

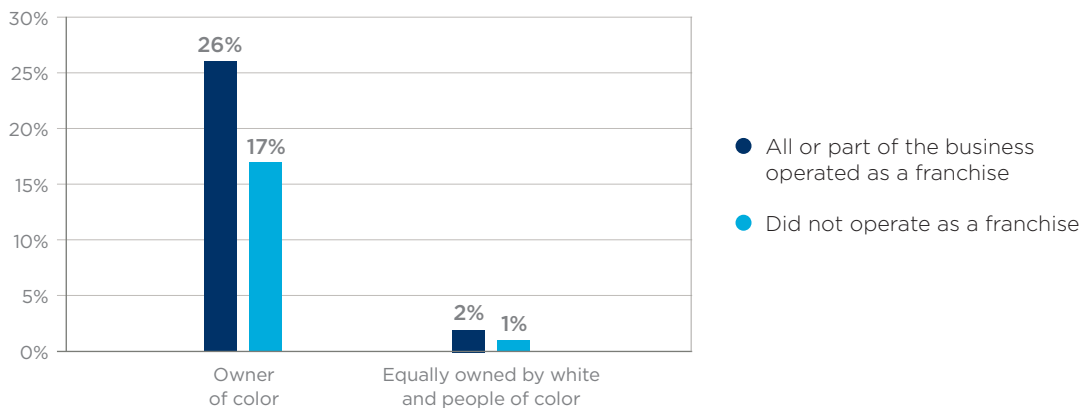


## 4.1.2 A diverse group of entrepreneurs

Entrepreneurs often face challenges including poor access to capital and lack of skills necessary to lead a business to survive and grow. **Women and people of color often face even greater obstacles.** For instance, social networks are an important input for entrepreneurial success. Evidence suggests that entrepreneurs of color have smaller and less connected networks than otherwise similar white entrepreneurs.<sup>27</sup> They also are less likely to have a family member who was self-employed and have lower levels of start-up capital for their businesses.<sup>28</sup> Finally, entrepreneurs of color may be more likely to face discrimination from investors and consumers.<sup>29</sup> In the remainder of this section, we will present some literature and descriptive statistics around the role of franchising in supporting entrepreneurship for some of these underrepresented groups.

Rast et al. (2020) demonstrate that, in the small business ownership realm, **franchisees of color and female owners are represented at a disproportionately higher rate**, thanks to the assistance the franchise business format affords.<sup>30</sup> The 2016 Annual Survey of Entrepreneurs also suggests that franchise establishments are more likely to have an owner of color than non-franchises (Fig. 8). About 17% of independent businesses are estimated to be owned by people of color, while around 26% of franchises are owned by people of color. This appears to be the case not only on average, but also across most of the major franchise industry sectors, including accommodation and food, retail, and administrative services.

**Fig. 8. Distribution of businesses by franchise status and owner's race**



Source: ASE (2016)

Specifically, franchises are more likely to be owned by Asian and Black entrepreneurs than non-franchised businesses (Fig. 9). Again, this holds true across the major franchise sectors. It should be noted that, regardless of franchise status, Black and

<sup>27</sup> Elizabeth Lyons and Laurina Zhang, "The Impact of Entrepreneurship Programs on Minorities," *American Economic Review*, 107(5) (2017): 303-07.

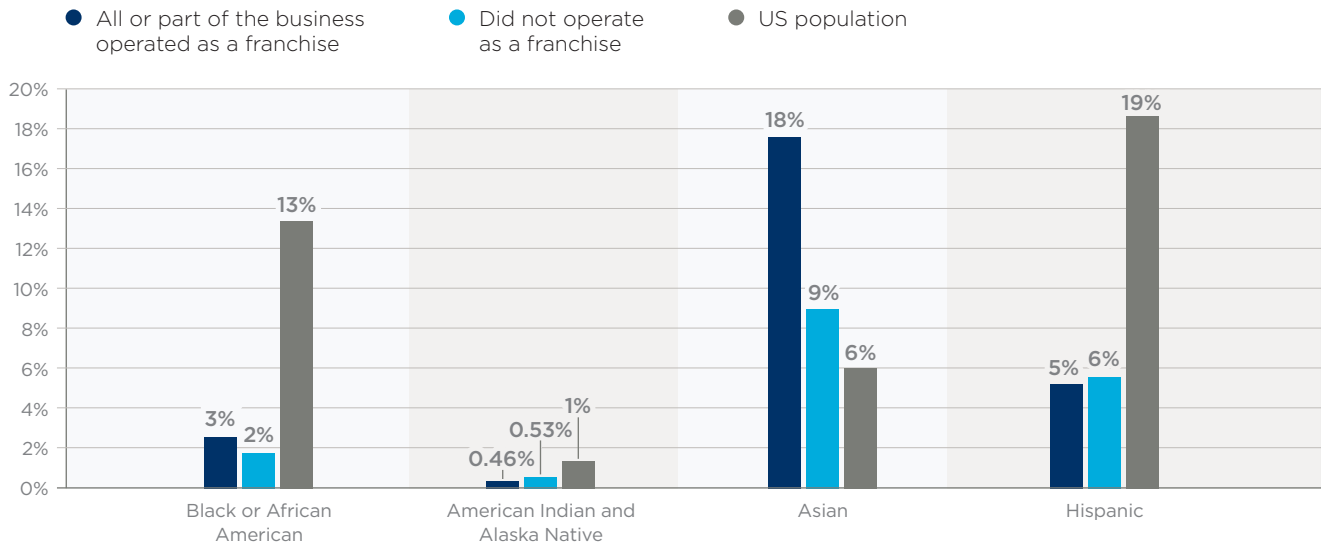
<sup>28</sup> Robert W. Fairlie and Alicia M. Robb, "Why Are Black-Owned Businesses Less Successful Than White-Owned Businesses? The Role of Families, Inheritances, and Business Human Capital," *Journal of Labor Economics*, 25(2) (2007): 289-323.

<sup>29</sup> Alison Wood Brooks, Laura Huang, Sarah Wood Kearney, Fiona E Murray, "Investors prefer entrepreneurial ventures pitched by attractive men," *Proceedings of the National Academy of Sciences*, 111(12) (2014): 4427-31.

<sup>30</sup> Rebecca Rast, Aaron Gleiberman, and Juliana White, "The Hidden Power of Franchising Curriculum: Delivering Value to Underrepresented Groups," *Journal of Entrepreneurship Education*, 23(2) (2020).

Hispanic entrepreneurs are underrepresented among business owners, compared with their relative share of the U.S. population, while the opposite is true among Asian business owners.

**Fig. 9. Distribution of non-white businesses by franchise status and owner's race/ethnicity, vis-à-vis U.S. population share<sup>31</sup>**



Source: ASE (2016), US Census Bureau

**Franchising has also proven to be a path to entrepreneurship for immigrants and newcomers in a variety of industries,** by allowing them to participate in fields where they lack prior experience. Kaufmann (1999) finds that franchisees were less likely than independent business owners to operate within sectors where they had previous experience.<sup>32</sup> In particular, franchisees were more likely to purchase a franchise outside their area of expertise than within (70% did so).

In conclusion, public policy has an important role to play in encouraging higher rates of entrepreneurship among women, non-white and other underrepresented groups. Supporting the franchise business model could be a helpful tool to achieve this outcome.

### 4.1.3 Survival and growth

Until the 1990s, the overarching belief was that franchised businesses had a much greater chance of success than starting an independent business.<sup>33</sup> In 1995, a *Journal of Small Business Management* study compared U.S. franchised to non-franchised firms' survival rates and found that independent businesses had a higher survival rate, and this prompted a series of further papers looking to shed light on the subject.<sup>34</sup>

<sup>31</sup> The U.S. Census Bureau does not define Hispanic as a Race, but as an Ethnicity.

<sup>32</sup> Patrick Kaufmann, "Franchising and the choice of self-employment," *Journal of Business Venturing*, 14 (1999): 345-62.

<sup>33</sup> Dianne H. B. Welsh; David E. Desplaces; Amy E. Davis, "A Comparison of Retail Franchises, Independent Businesses, and Purchased Existing Independent Business Startups: Lessons From the Kauffman Firm Survey," *Journal of Marketing Channels*, 18(1) (2011): 3-18.

<sup>34</sup> Timothy Bates, "Analysis of survival rates among franchise and industry small business startups," *Journal of Small Business Management*, 33(2) (1995): 26-36.

In theory, it is far from clear whether franchised or independent businesses should have a survival advantage. On the one hand, starting a business as a franchise should be less risky than launching an independent business, because franchisees benefit from their franchisor's brand name awareness and know-how and may realize cost savings from more efficient supply chains and bulk purchasing.

Independent business owners, however, retain complete autonomy, allowing them to adapt as needed to their local market and changing market conditions, possibly enabling superior performance. The coexistence of both types of businesses in the marketplace suggests that neither form of business ownership clearly dominates the other. As previously discussed, theory suggests that entrepreneurs will choose to franchise rather than establish an independently owned business when they forecast that a franchised venture will give them higher expected utility (in the shape of both likelihood of success and survival) than other opportunities, including going independent.

In a 2018 article, Lafontaine et al. examine survival and growth prospects of franchised and independent businesses.<sup>35</sup> They find that franchised businesses on average exhibit slightly higher **survival rates** than independent businesses, although the effect appears to be short lived (one to two years). This is however still very relevant, considering that one third of new businesses are estimated to fail within their first two years.<sup>36</sup> In addition, the authors find that franchised businesses grow faster than independent businesses in the first two years, but no difference is detected beyond that point.

The small survival advantage is attributed to franchisors' screening process (independent businesses are only screened when financed via outside sources, such as a bank loan) and the benefits arising from the brand and business know-how provided by franchisors. This article shows that the franchise model can help businesses get past the period when they are most likely to fail, i.e., the first few years. Contingent on having survived that period, the authors find that non-franchises are as likely to survive.

When it comes to **growth**, overall, the existing research finds a positive financial impact of franchising.<sup>37</sup> Among the research comparing franchisee- and company-owned establishments, Ackermann (2019) finds that franchising an Applebee's store has a positive impact on store revenues and consumer utility.<sup>38</sup> Similarly, Litz and Stewart (1998) find that participation in a trade-name franchise has a positive impact on small retailers' performance.<sup>39</sup> As noted in these articles, the most prevalent theory for why a franchised store should outperform a company-owned store relates to the principal-agent theory described in section 2.1. A second theory argues that a local franchisee is more likely to know important information about its market and therefore be better able to customize a store to fit its client base.



**The main advantage of franchising is the ability to grow faster at start-up.**

**Franchise census respondent**

<sup>35</sup> Francine Lafontaine, Marek Zapletal, Xu Zhang, "Brighter prospects? Assessing the franchise advantage," *Journal of Economics and Management Strategy*, 28 (2019): 175-97.

<sup>36</sup> US Small Business Administration Office of Advocacy, October 2020.

<sup>37</sup> Nan Hua and Michael C. Dalbor, "Evidence of franchising on outperformance in the restaurant industry," *International Journal of Contemporary Hospitality Management*, 25(5) (2013): 723-39.

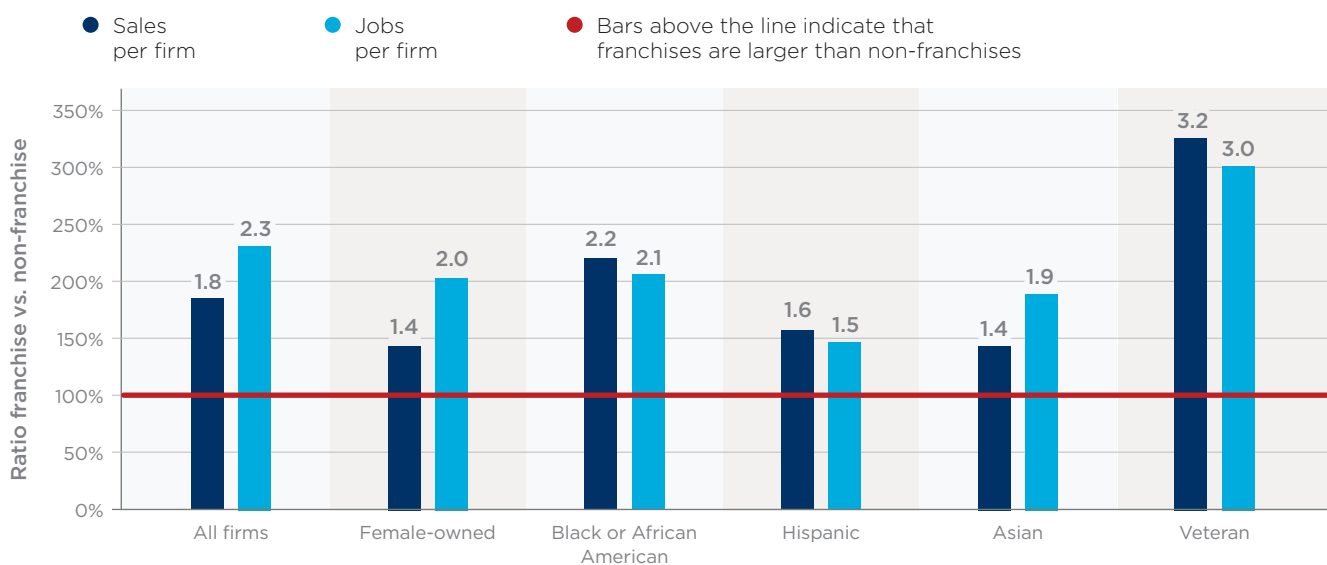
<sup>38</sup> Jeff Ackermann, "The Effect of Franchising on Store Performance: Evidence from an Ownership Change," *Management Science*, 65(11) (2019): 5188-96.

<sup>39</sup> Reginald A. Litz and Alice C. Stewart, "Franchising for sustainable advantage? Comparing the performance of independent retailers and trade-name franchisees," *Journal of Business Venturing*, 13(2) (1998): 131-50.

## 4.2 THE DATA

Generally speaking, the 2016 Annual Survey of Entrepreneurs suggests that franchise businesses tend to be larger than independent businesses. We find that, on average, franchises report sales 1.8 times as large as non-franchise businesses and jobs 2.3 times as large as non-franchise businesses (Fig. 10). Sales and jobs in franchise businesses exceed non-franchise businesses across all demographic cuts. For example, Black or African American franchise firms earn 2.2 times as much in sales compared to Black-owned independent businesses, on average. Similarly, veteran-owned franchises report average sales 3.2 times as large as veteran-owned non-franchise businesses.

**Fig. 10. Ratio of average sales per firm and jobs per firm, franchise vs. non-franchise businesses**



On average, franchise firms have

**1.8 times**  
THE SALES and



**2.3 times**  
THE EMPLOYMENT

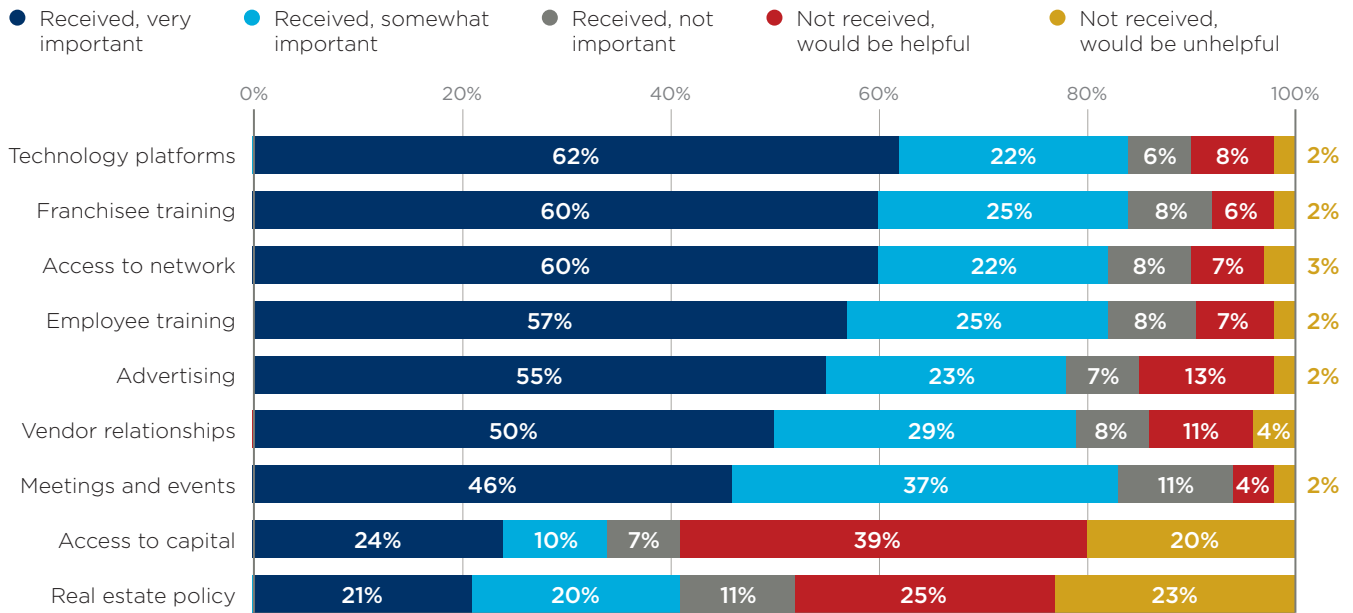


of non-franchise firms.

Source: ASE (2016)

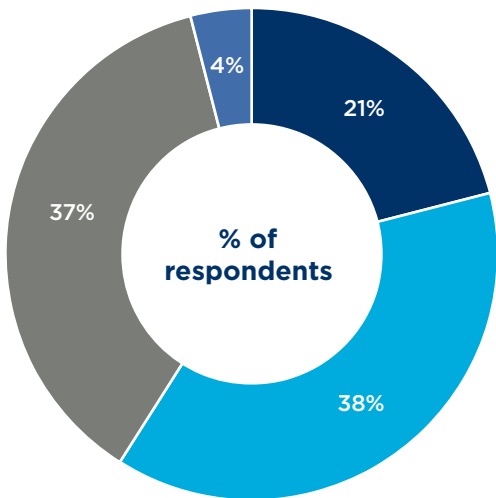
What factors enable franchised businesses to reach a larger scale? As described in section 4.1.3, franchisees benefit from their franchisor's brand name awareness and know-how and may realize cost savings from more efficient supply chains and bulk purchasing, among other things. In order to test which elements of franchisor support prove most helpful to franchisees, we asked them to rate a series of statements and Fig. 11 presents our findings. Results suggest the important areas of support received from franchisors are franchisee training (e.g., sales/marketing training and mentoring programs), meetings & events (e.g., conferences and conventions targeting franchisees), and technology platforms (e.g., applications to monitor key performance indicators).

**Fig. 11. Areas of franchisor support**



Source: Franchise census

Even in areas where franchisor support is less widespread, such as access to capital support (received by 42% of respondents), the positive effects of the business model are striking. Some 21% of respondents report being capital constrained when starting their first franchise business and that being a franchisee provided them with access to capital (Fig. 12). This share is slightly larger among female owners and owners for whom a franchise was their first business (23%).

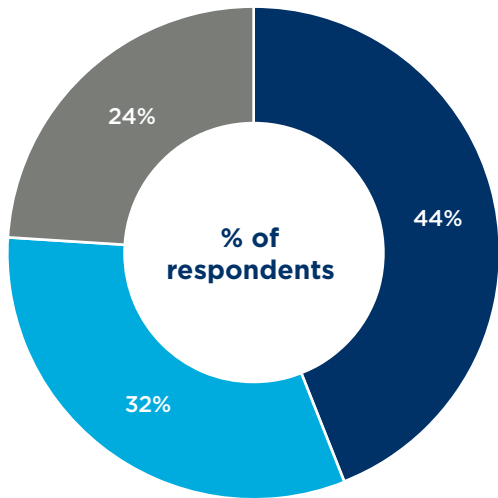


**Fig. 12. Answer to “Were you capital constrained when you started your first franchise business?”**

- Yes, and being a franchisee provided me with access to capital
- Yes, but eventually obtained sufficient access to capital without any advantage of being a franchisee
- No
- Other

Source: Franchise census

In addition, 32% of respondents reported they would not own a business if they were not franchisees (Fig. 13). This proportion is even greater among female owners and owners for whom a franchise was their first business (39%). When applied to the total number of franchise firms from the 2016 ASE, this would be equivalent to a loss of 60,000 businesses if franchising was not an option.



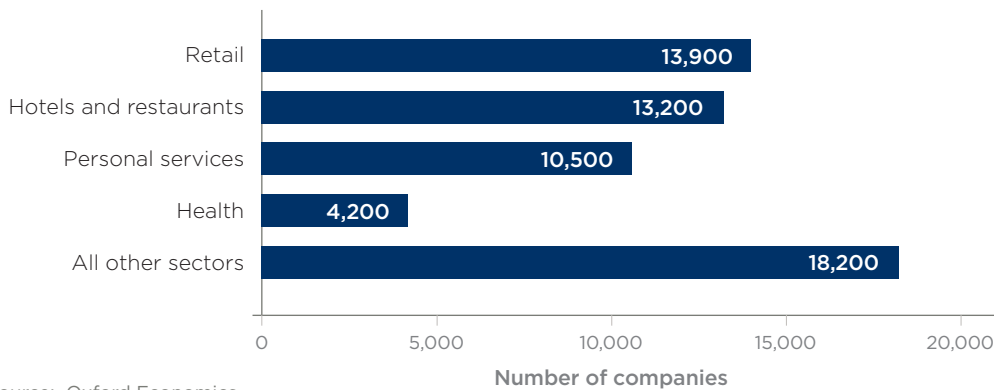
**Fig. 13. Alternatives to owning a franchise**

- If I was not a franchisee today, I would have become an owner of an independent, non-franchise business
- If I was not a franchisee today, I would not own a business
- Not sure

Source: Franchise census

Of the 60,000 businesses that may not have been established if franchising was not an option, nearly 14,000 would be in retail, over 13,000 in hotels & restaurants, and over 10,000 in personal services (Fig. 14). We estimate that these 60,000 businesses jointly own nearly 223,000 establishments and employ almost 1.8 million workers, whose jobs may not have existed without franchising.

**Fig. 14. Number of firms that may not exist without franchising, by industry**



Source: Oxford Economics



## THE PRO ACT

The “Protecting the Right to Organize” Act, or the PRO Act, passed the House in March, as part of the American Jobs Plan. The act would provide protections for workers trying to organize, while penalizing companies that restrict union activity. Among its many provisions, the bill would codify into law an expanded **“joint employer” standard**, whereby franchisors can be held responsible for actions taken by their franchisees. This clearly makes franchisors much less willing to partner with local entrepreneurs, thereby reducing small business ownership opportunities in the franchise world.

Another PRO Act provision that is likely to considerably affect the franchising economy is the so-called **“ABC test”** to determine when individuals can be classified as independent contractors. In its present form, the provision’s language is quite broad, suggesting that franchisees could end up being classified as employees of their brand, instead of the owners that they really are. This would essentially eliminate the entire concept of franchising as a business model.

Chapter 4 of this study has shown the important role played by franchising as a pathway to entrepreneurship and it is important for labor regulations to treat franchisees as business owners rather than simple employees.

# 5. FRANCHISEES AS NEIGHBORS

Entrepreneurs can help boost their hometowns and neighborhoods by either starting an independent business or by joining an established franchise network and becoming franchisees. Some might argue that franchising is not directly connected to local economic growth, but just because franchisees buy into a known brand does not mean that they are not creating local benefits.

Many franchisees are essentially small business owners, who live and work in their communities. The brands they represent do not ship jobs in from other parts of the country, but rather franchisees recruit and hire local residents. By doing so, **the franchise business model encourages local employment and wealth-sharing with local communities.**

## 5.1 THE LITERATURE

In Chapter 4, we have looked at franchising as a path to business ownership for franchisees. Clearly, the appeal of such an opportunity depends on the ability of franchisees to generate substantial revenue from the initial investment. The literature on contracts predicts that some principals (in this case franchisors) will pay agents (in this case franchisees) an amount larger than that necessary to keep the agent in the contract.

Kaufmann and Lafontaine (1994) study the case of McDonald's to empirically show that the franchisor often does not extract the maximum possible surplus from the franchisee, but rather leaves profits to be made by them.<sup>40</sup> The reason for picking McDonald's as a case study is that, if any franchisor was able to extract all surpluses, McDonald's certainly would be. Thus, the existence of significant amounts of profits downstream at McDonald's suggests that this company purposefully chooses to leave such income to its franchisees.

Most incentive theories of franchising assume that, whenever there is competition among franchisees, a franchisor can obtain the net present value of the ex-post income from the franchisees via an upfront franchise fee. However, the authors show that the type of individuals that McDonald's wants to recruit as franchisees, namely, owner-operators whose livelihoods are dependent on their units, are especially likely to face liquidity constraints. This in turn increases the need for McDonald's to leave sufficient profits with its franchisees.

In addition, it should be noted that, despite its size, McDonald's is not the dominant player in the QSR sector, as it competes with other franchise brands including KFC, Subway, Domino's, Taco Bell and Dunkin'. As a consequence, franchisees can choose to shop around if McDonald's franchise conditions



*Being an independent franchise owner is positive for our local community in many ways. We work with local vendors, local charities, support local community associations, and hire and develop local employees.*

Franchise census respondent

<sup>40</sup> Patrick J. Kaufmann and Francine Lafontaine, "Costs of Control: The Source of Economic Rents for McDonald's Franchisees," *The Journal of Law & Economics*, 37(2) (1994): 417-53.

were subpar compared with similar brands. This is yet another reason for franchisors to offer a competitive and profitable contract, which can appeal to prospective franchisees.

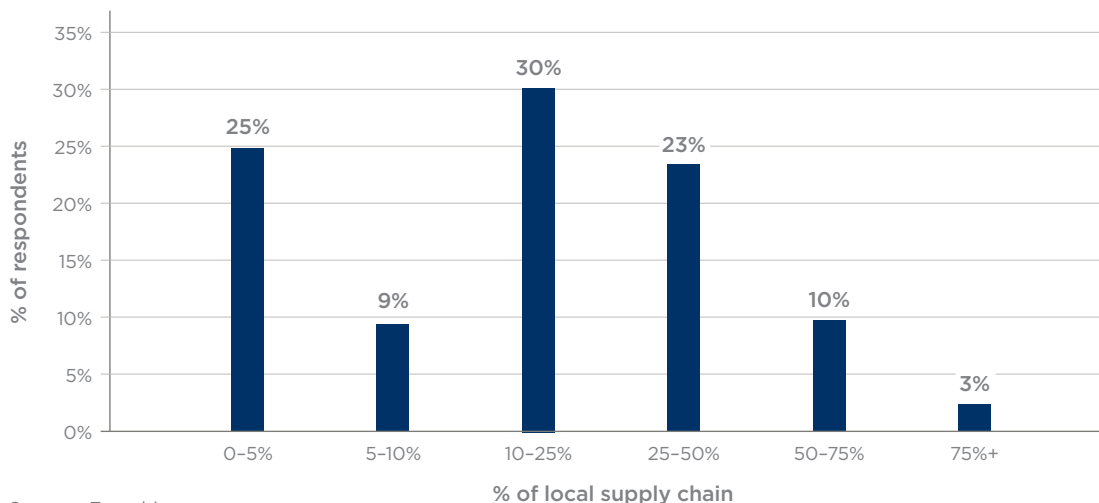
This paper represents one of the most relevant proofs that the franchise model is designed to purposefully create incomes for its franchisees, which in turn means redistributing wealth across the country rather than allocating 100% of the profits to the community where the brand's headquarter is based.

The interlinkages between the franchise model and local communities, however, go beyond the pure profit-sharing relationship between franchisor and franchisees. As franchisees operate typically in markets and communities of which they are themselves members, they have considerable local knowledge, which franchisors lack.<sup>41</sup> Their belonging to such communities makes them more attentive to the needs of their fellow community members. As we will show in the next section, franchisees act much more alike small independent businesses when it comes to community giving, as opposed to large corporations.

## 5.2 THE DATA

There are many ways for companies to positively contribute to the local economy. These include hiring locally and training their workforce, which in turn lead to positive productivity spillovers and further economic benefits as employees spend money in the area at retail and leisure outlets. Using local suppliers for sourcing intermediate goods and donating to local organizations can also further support the socio-economic development of the region. In addition, firms pay local taxes, including property taxes, which are then used to fund local fire departments and schools.

**Fig. 15. Share of respondents by proportion of local supply chain**



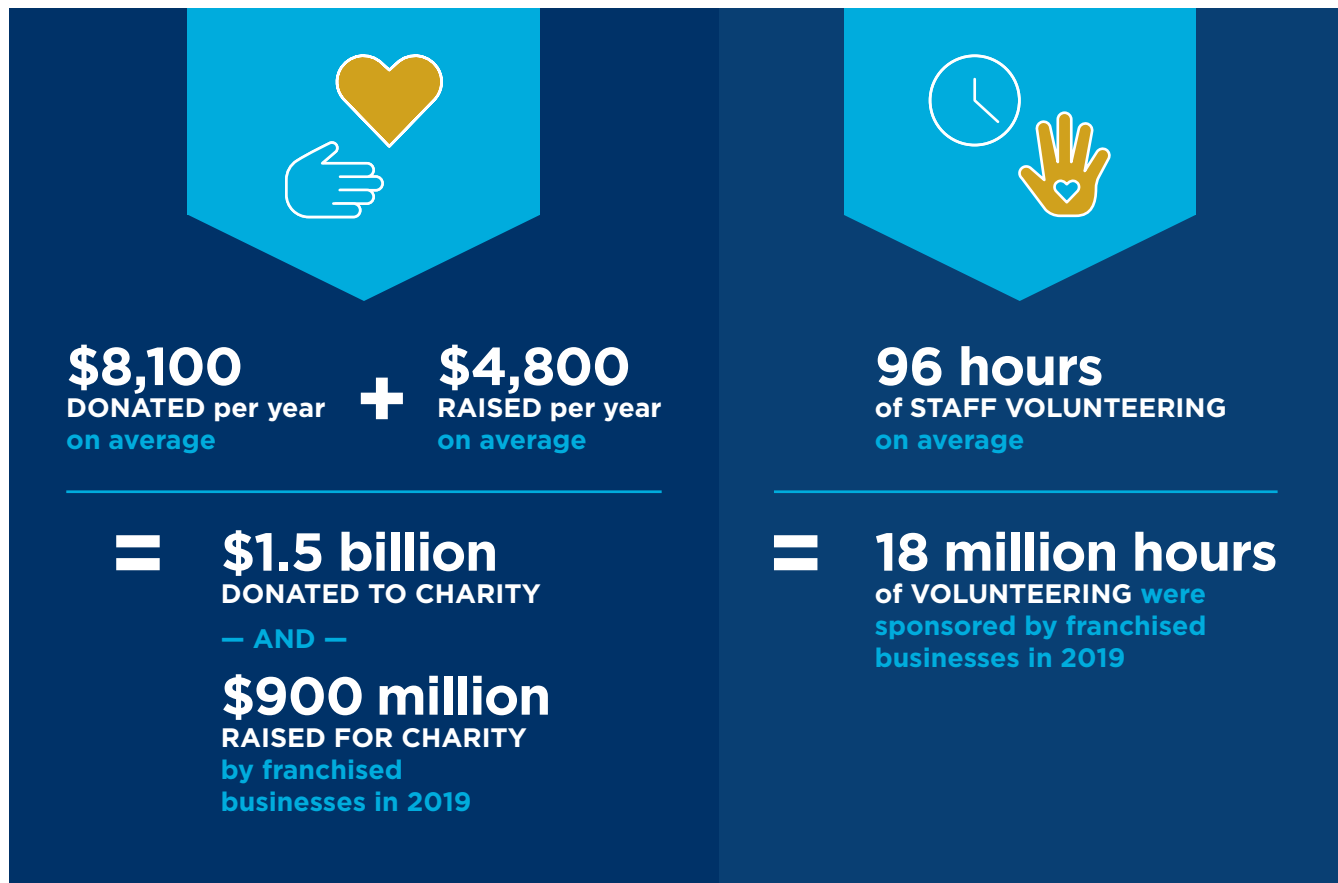
Source: Franchise census

<sup>41</sup> Anna Watson, John Stanworth, Simon Healeas, David Purdy, Celia Stanworth, "Retail franchising: an intellectual capital perspective," *Journal of Retailing and Consumer Services*, 12 (2005): 25-34.

Franchisee-owned units are not unlike any other company. Some 90% of our survey respondents reported having received franchisor support training their workers (see Fig. 11) and each employee is estimated to receive an average of 33.4 hours of formal training every year (as detailed in Section 3.2.2). Our survey also suggests that franchisees purchase 21% of their inputs from local suppliers, and over a third of firms (36%) purchase at least 25% of their intermediate goods locally (Fig. 15).

In addition, some 65% of franchisees reported giving to local charities, according to our survey. This is in line with findings from SCORE that suggest that 66% of small businesses do so.<sup>42</sup> Among donors, franchises donate an average of 6% of their profits (also in line with SCORE’s findings on small businesses).

According to our survey, franchise businesses donated an average of \$8,100 per year, and raised another \$4,800 in the year prior to the pandemic. In addition, they sponsored an average of 96 hours of staff volunteering in that same period to improve and strengthen their communities. When scaled to the entirety of the franchised ecosystem, we estimate that companies operating as a franchise donated a total of \$1.5 billion to charity in the year before the pandemic and raised over \$900 million over the same period. Some 18 million hours of volunteering were sponsored by franchised businesses in 2019, which are worth hundreds of millions of dollars to society more broadly.



<sup>42</sup> SCORE, “Small Businesses Giving Back Makes a Big Impact on Local Communities,” 18 January 2019.

# 6. CONCLUSION

The franchise business model plays an important role within the U.S. economy. Prior to the pandemic, in 2019, the economic output of franchise establishments in the United States was about \$787.5 billion and represented 3% of the country's GDP. Contributing to this output were about 8.4 million people who worked for a franchise business.

Franchises are represented in all states and sectors of the economy. Most people immediately associate franchising with fast food restaurants. However, quick service restaurants are just a fraction of the entire sector, making up only a fourth of all franchised establishments, less than half of the workers, and just over a third of the economic output.

Beyond their economic contribution, we find that franchises offer pay, benefits, and training on par with comparable non-franchise small businesses. In addition, 32% of franchisees report they would not own a business if they were not franchisees. When applied to the total number of franchise firms, this would be equivalent to a loss of 60,000 businesses if franchising was not an option. Lastly, we highlight how franchisees are embedded in their local communities through their local supply chains and charitable giving.

Given their importance to the U.S. economy, franchises will be vital for achieving a speedy and sustained economic recovery from the pandemic.

# METHODOLOGICAL APPENDIX

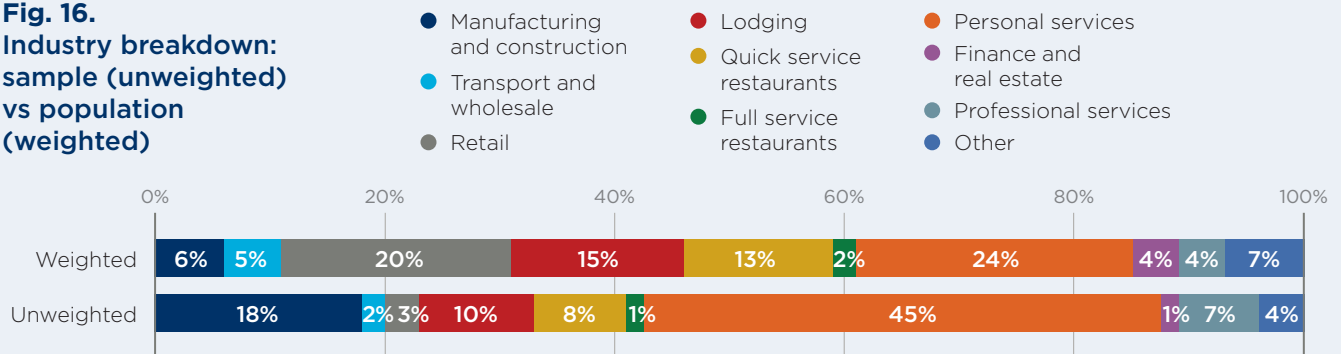
## FRANCHISE CENSUS

In April-May 2021 a sample of U.S.-based franchisees was asked to complete a survey (the franchise census) about their businesses and their experience with franchising. The sample included 4,253 franchise businesses and it represents a unique source of data about the sector, which was previously lacking. The survey, fielded and administered by Oxford Economics through the survey platform Survey Monkey, polled respondents from all major industry sectors. The list of survey questions is [available here](#).

The survey included currently active companies and its responses (some of which including sensitive corporate information) were confidential. Respondents were informed that only Oxford Economics would have access to the raw data (not IFA or franchisors) to avoid any risk of identification and encourage candid responses. As the data was collated, specific sectors were targeted to enhance response rates across the industry spectrum. Along several dimensions, our sample matched existing evidence well, suggesting a rather representative response base. The questionnaire was designed and approved by the Oxford Economics' survey team, which ensured the questions were posed as objectively as possible.

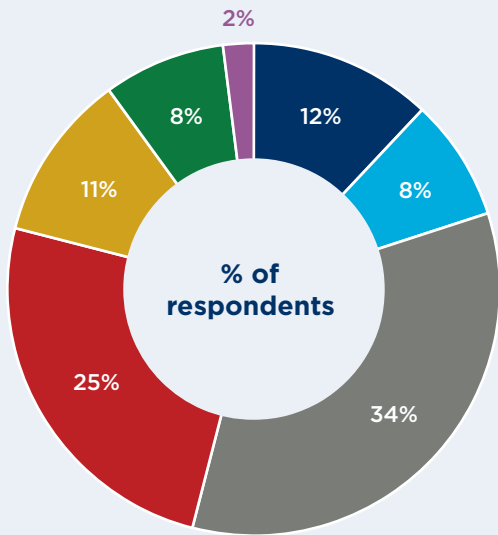
We benchmarked our sample to the 2016 Annual Survey of Entrepreneurs (ASE), so the weighted responses exactly match firm counts by industry from that survey. As illustrated in Fig. 16, our responses underrepresent retail and hotels & restaurants, and overrepresent manufacturing & construction and personal services. In general, however, our sample covers all the major industries where franchising is present.

**Fig. 16.**  
Industry breakdown:  
sample (unweighted)  
vs population  
(weighted)



Source: Oxford Economics

Our sample also encompasses businesses of different sizes (Fig. 17). About one in five respondents reports annual revenue of \$250,000 or less, one in three earns between \$250,000 and \$1 million, one in four makes \$1-2.5 million a year and the remaining 21% earns \$2.5 million or more per annum.



**Fig. 17. Share of respondents by annual revenue**

- <\$100k
- \$100k-\$250k
- \$250k-\$1M
- \$1M-\$2.5M
- \$2.5M-\$5M
- \$5M-\$50M
- \$50M+

Source: Oxford Economics

## HOMEBASE DATA AND ANALYSIS

The Homebase data used in this analysis cover the period from January 1, 2018 through December 31, 2019.<sup>43</sup> The dataset consists of 124 million worker-day observations, indicating, on a given day, the number of hours the worker worked, the wages earned (although wages earned are missing in 41% of daily observations), and whether or not an individual worker was a manager.<sup>44</sup> There were a total of 140,880 companies in the data, operating at 160,392 locations, with 1.9 million total workers represented over the two years.<sup>45</sup> Business names were provided to us by Homebase and were matched to a list of franchise brand names from FRANData using a fuzzy matching algorithm that was then hand-checked. This resulted in the identification of 3,720 franchises (2.6% of all companies).<sup>46</sup> Additional company and location-level data elements include industry (classified into 11 industries—see Fig. 19), and, for most locations, the state and county.<sup>47</sup> It should also be noted that we believe our Homebase sample largely includes franchisee-owned establishments, and not company-owned establishments that are unlikely to use an inexpensive payroll software such as Homebase.

**Fig. 18. Summary statistics for monthly Homebase data**

|               | Sample    | Variable           | Observations | Mean  | Std. Dev. | Min  | Max    |
|---------------|-----------|--------------------|--------------|-------|-----------|------|--------|
| Franchise     | Workers   | Hourly wage        | 72,635       | 10.54 | 2.73      | 2.13 | 25.01  |
|               |           | ln(wage)           | 72,635       | 2.32  | 0.27      | 0.76 | 3.22   |
|               |           | Missing wage       | 121,461      | 0.40  | 0.49      | 0.00 | 1.00   |
|               |           | Hours worked       | 120,555      | 75.31 | 53.03     | 0.00 | 298.87 |
|               |           | Manager            | 120,555      | 0.07  | 0.26      | 0.00 | 1.00   |
|               | Companies | # workers per firm | 9,628        | 12.62 | 18.43     | 1.00 | 245.00 |
| Non-franchise | Workers   | Hourly wage        | 1,413,628    | 10.58 | 3.28      | 2.13 | 25.01  |
|               |           | ln(wage)           | 1,413,628    | 2.30  | 0.37      | 0.76 | 3.22   |
|               |           | Missing wage       | 2,411,741    | 0.41  | 0.49      | 0.00 | 1.00   |
|               |           | Hours worked       | 2,387,928    | 83.38 | 59.39     | 0.00 | 300.00 |
|               |           | Manager            | 2,387,928    | 0.06  | 0.24      | 0.00 | 1.00   |
|               | Companies | # workers per firm | 284,508      | 8.48  | 15.18     | 1.00 | 973.00 |

<sup>43</sup> Data from Homebase can be requested at: <https://joinhomebase.com/data/>.

<sup>44</sup> The precise reason why wages are missing is unknown to us. Some Homebase users may use the system purely for timekeeping and so may not enter wage information into the system. Additionally, some of the workers with missing wage information may be salaried rather than hourly employees.

<sup>45</sup> A small number of workers worked at more than one company over this period; however, we treat each company-worker pair as a distinct individual for the analysis. Note that “company” and “location” are the terms used in the Homebase system, and so we adopt these over firm and establishment.

<sup>46</sup> According to Homebase, these business names were collected from multiple sources, some entered by users and others taken from public sources like Google maps. We believe that the large majority of companies we identified as likely franchises are, in fact, franchises based on the use of a franchise brand in the business name. On the other hand, the remaining non-franchise sample likely contains a small number of franchises we failed to identify because of their more generic names. Since the share of franchises in the overall dataset is small to begin with, we do not believe this significantly biases our analysis.

<sup>47</sup> We focus on companies as the core element of analysis, rather than locations, identifying franchises at the company level. For a small number of companies with multiple locations with different industry codes, we assign the company the code with the greater number of worker-days worked. For a small number of workers who work at multiple locations within one company in a single month, we assign the worker the location they worked on more days, or in the event of a tie, more hours, in that month for the purpose of our location-specific regressions.



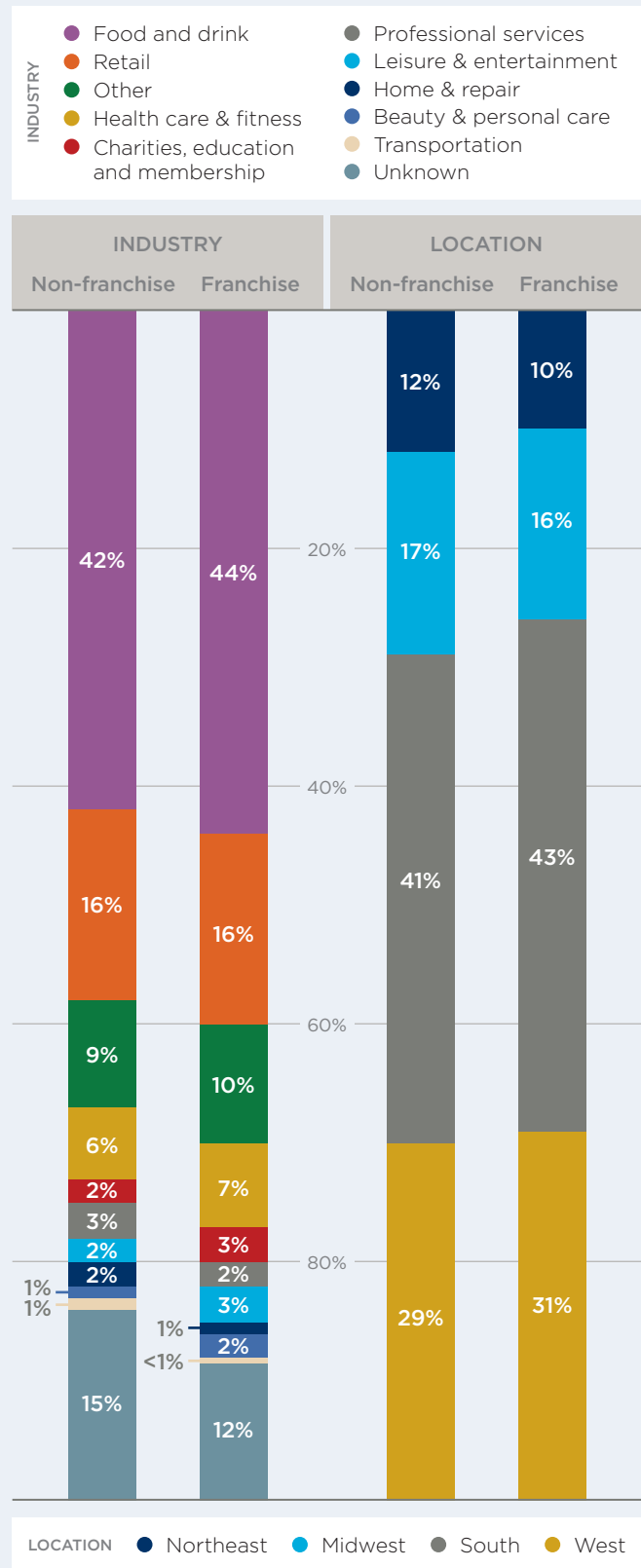
For our analysis, we aggregate the daily data to monthly observations. This was done primarily to avoid daily wage fluctuations, for example due to overtime pay, and to better match the time scale of wage (re)setting. Workers were considered managers if they had that status on at least one day of the month, although in practice workers rarely move back-and-forth between manager and non-manager status. Wages were averaged for individual workers over all days where hours and earnings were available. The top and bottom 1% of wages were discarded as outliers (which correspond to \$2.13, coincidentally almost exactly the Federal tipped minimum wage, and \$25.01 per hour), as were observations where the number of hours worked in the month was less than zero or greater than 300.<sup>48</sup> Summary statistics for this dataset are presented in Fig. 18.

It deserves note that 35% of the franchise and 43% of the non-franchise worker-month observations are missing wage data and therefore do not factor into our wage-based analysis. Also noteworthy is the fact that average hourly wages are slightly higher for non-franchise firms, while log wages, which we use in our regression analysis, are slightly higher for franchises. This implies that franchises in our sample are paying higher wages lower in the wage distribution, while non-franchises are paying higher wages higher in the distribution, although the overall difference is very small.

Overall, the franchise and non-franchise samples are very well matched. This includes their industry and regional distributions, shown in Fig. 19. One area where the two groups do not entirely align is in the number of distinct workers that companies employ in a month. Franchise firms average 14 workers, while non-franchises average 10 workers. This may partly explain the 13% higher number of hours non-franchise workers in our sample work per month: 87 versus 77 hours.

<sup>48</sup> The number of observations dropped based on hours worked was small, and results are not sensitive to this exclusion. On the other hand, results are somewhat sensitive to the wage threshold definitions of outliers, with results in some cases losing their statistical significance when other wage cutoffs were used. This is a primary reason we emphasize the overall similarity of franchise and non-franchise workers' wages rather than the small franchise premium seen in the wage regressions.

**Fig. 19. Comparison between franchise and non-franchise firms by industry and location**



## High quality sub-sample

For part of our analysis, we focus on companies that appear to be using the Homebase system continuously over the 24 months in our data. Specifically, we discard data from any company that does not have any observations in any of the 24 months in our sample. Overall, the restricted sample consists of 443 franchise firms and 13,589 non-franchise firms, or about 12% and 10% of franchise and non-franchise firms respectively. While this subsample represents only about 10% of the firms in our data, the fact that these firms are the heaviest users of Homebase results in it including roughly a quarter of the worker-month observations (this can be seen by comparing observation counts in Fig. 18 and Fig. 20).

**Fig. 20. Summary statistics for monthly Homebase heavy users subsample**

|               | Sample    | Variable           | Observations | Mean  | Std. Dev. | Min  | Max    |
|---------------|-----------|--------------------|--------------|-------|-----------|------|--------|
| Franchise     | Workers   | Hourly wage        | 72,635       | 10.54 | 2.73      | 2.13 | 25.01  |
|               |           | ln(wage)           | 72,635       | 2.32  | 0.27      | 0.76 | 3.22   |
|               |           | Missing wage       | 121,461      | 0.40  | 0.49      | 0.00 | 1.00   |
|               |           | Hours worked       | 120,555      | 75.31 | 53.03     | 0.00 | 298.87 |
|               |           | Manager            | 120,555      | 0.07  | 0.26      | 0.00 | 1.00   |
|               | Companies | # workers per firm | 9,628        | 12.62 | 18.43     | 1.00 | 245.00 |
| Non-franchise | Workers   | Hourly wage        | 1,413,628    | 10.58 | 3.28      | 2.13 | 25.01  |
|               |           | ln(wage)           | 1,413,628    | 2.30  | 0.37      | 0.76 | 3.22   |
|               |           | Missing wage       | 2,411,741    | 0.41  | 0.49      | 0.00 | 1.00   |
|               |           | Hours worked       | 2,387,928    | 83.38 | 59.39     | 0.00 | 300.00 |
|               |           | Manager            | 2,387,928    | 0.06  | 0.24      | 0.00 | 1.00   |
|               | Companies | # workers per firm | 284,508      | 8.48  | 15.18     | 1.00 | 973.00 |

## Regression analysis

Fig. 21 presents the results of our regression results and the program file to generate these results [can be accessed here](#). Overall, we find a positive wage effect of 2.2% to 3.4% higher wages for franchise as for non-franchise employees, although these results are not uniformly statistically significant. With mean wages of around \$11 per hour, this corresponds to approximately \$0.24-0.37 per hour in higher wages. The first (Basic) regression includes only a franchise dummy and 23 month dummies to control for inflation and other time-specific factors. The Full specification includes our additional explanatory variables: a dummy for manager and full-time status, the log size of the company, and industry dummies. Adding these variables causes the positive effect of franchise employment on wages to increase from 2.2% to 3.4%, which is statistically significant at 1%. The third specification (County FE) adds county-level fixed effects to control for geographic effects on wages. This reduces the magnitude of the franchise effect back to 2.3%. These same three regressions are also repeated on our restricted high-quality subsample with similar overall results, although the statistical significance is reduced owing to the smaller sample size.

Our regression analysis finds small, and in some cases statistically significant, wage premium for working at a franchise. This is in spite of the fact that the simple mean wage at non-franchise firms was slightly higher at franchise firms (\$11.24 per hour vs. \$11.06 per hour). Overall, the wages at franchises and non-franchises in the Homebase data are quite similar, which is what we would expect of the relatively low-pay, likely wage-taking, firms that use Homebase.

**Fig. 21. Regression results with  $\ln(\text{wage})$  as dependent variable**

|                   | Full sample         |                     |                       | Restricted sample   |                     |                     |
|-------------------|---------------------|---------------------|-----------------------|---------------------|---------------------|---------------------|
|                   | Basic               | Full                | County FE             | Basic               | Full                | County FE           |
| Franchise         | 0.0221*<br>(0.011)  | 0.0345**<br>(0.011) | 0.0231***<br>(0.006)  | 0.024<br>(0.020)    | 0.031<br>(0.019)    | 0.0271**<br>(0.010) |
| Manager           |                     | 0.122***<br>(0.003) | 0.129***<br>(0.003)   |                     | 0.115***<br>(0.005) | 0.123***<br>(0.004) |
| Full-time         |                     | 0.162***<br>(0.004) | 0.149***<br>(0.003)   |                     | 0.162***<br>(0.005) | 0.151***<br>(0.004) |
| Ln (Company size) |                     | 0.005<br>(0.004)    | -0.0123***<br>(0.003) |                     | 0.011<br>(0.007)    | -0.005<br>(0.004)   |
| Constant          | 2.285***<br>(0.004) | 2.321***<br>(0.019) | 2.349***<br>(0.017)   | 2.294***<br>(0.004) | 2.340***<br>(0.033) | 2.372***<br>(0.025) |
| Month dummies     | Yes                 | Yes                 | Yes                   | Yes                 | Yes                 | Yes                 |
| Industry dummies  | No                  | Yes                 | Yes                   | No                  | Yes                 | Yes                 |
| County dummies    | No                  | No                  | Yes                   | No                  | No                  | Yes                 |
| N                 | 5,535,093           | 5,535,093           | 5,351,231             | 2,817,406           | 2,817,406           | 2,744,447           |
| R2                | 0.006               | 0.108               | 0.367                 | 0.003               | 0.091               | 0.386               |

\*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

Firm clustered standard errors in parentheses

## New workers

In order to obtain a balanced sample on worker characteristics, we examine new hires and then follow their wage progression month-by-month. Specifically, we consider a worker “newly hired” if they do not work for their employer in the first month of the dataset (January 2018). Of course, these workers may have previously worked for the same firm but been absent for the month of January 2018. To test this, we looked at those workers who did not work in January 2019 but did work later in that year. Of these workers, 18% had worked for the same company at some point in 2018, meaning that our sample of “new hires” also contains a significant number of “returners” as well. Lengthening the time away to January plus February only reduced this share to 16%.

In Fig. 4, we show the average wage of newly hired workers at franchise and non-franchise firms respectively, labeled with the difference between franchise and non-franchise wages. In order to control for compositional differences in the sample month-to-month, we begin both samples in month 1 with the average wage of starters, then, for each subsequent month, calculate the mean change in wages for all workers who are employed in both month  $i$  and month  $i+1$ . We considered alternate versions of this analysis, including simple mean wages of remaining workers in each month, following a subsample of workers who remain with their employers over long periods, interpolating wages for workers absent in a given month who return in subsequent months, and taking modal daily wage rather than average monthly wage to avoid any complications from overtime or holiday pay. Results were similar in each of these sensitivity checks, although more volatile in the case of simple means, especially in later months where the sample size falls.

We also find that the retention rates of franchise and non-franchise firms never differ by more than 2 percentage points. To calculate retention rates, workers were split into four groups: those working in a given month, those absent (meaning they were not working for the same employer but they would return in a subsequent month), those departed (meaning they were not working for the same employer and weren't observed returning in a subsequent month), and those censored (meaning the month in question was after the last month in the data [December 2019] and they were observed working for their employer in December 2019). The retention rates shown are:  $(\# \text{ working} + \# \text{ absent}) / (\# \text{ working} + \# \text{ absent} + \# \text{ departed})$ .



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