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FRANCHISE SUCCESS, ECONOMIC GROWTH AND NET JOB CREATION IN A DEVELOPED ECONOMY: A CASE STUDY OF UNITED STATES OF AMERICA

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ABSTRACT
Entrepreneurs of all sizes will always remain important to the growth of a country's economy which United State America is not an exception. Therefore, franchised business shall continue to remain an essential segment of the larger small business population. Most often, franchised business account directly for greater percentage of growth in product manufacturing and distribution which could be considered as a strong positive sign of economic growth, though employment picture may remain weak. Small business owners-including franchise – continue to cite access to capital as the major business problem. It is against this backdrop that the paper shall examine many of the recent challenges faced by small business owners, ranging from cyclical worries about sales to the credit struggles which were exacerbated by the unique sources of economic downturn. The paper will also highlight how certain entrepreneurial ventures will propel United state's economy within a particular time frame; providing new sources of economic vitality and employment to its, increasingly marked place. These high-impact businesses have remained good sources of innovation and growth.

Keywords: Entrepreneurs, Franchise, Credit, Economic downturn.

INTRODUCTION
Americans especially in these challenging economic times when net job creation is at a premium appreciates the entrepreneur. Part of this is the mystique of the small business owner and the role that mom-and-pop establishments play in communities. But it is also due to the tremendous impact that they have on its local, regional, and national economies. Research shows that firms with less than 500 employees account for half of the nation's real gross domestic product (GDP), employ half of the economy since 1993.

Franchised businesses are an essential segment of the larger small business population. In 2007, franchised small businesses were directly responsible for 7.76 million and 1.37 million jobs, respectively, in businesses format and product distribution franchises. This totals to 9.1 million jobs, or 6.2 percent of the total non-farm, private sector employment. To illustrate its importance, franchise employment is roughly equivalent to the number of jobs in durable goods manufacturing, and it exceeds the total employment of such major industries as finance and insurance, real estate and rental and leasing, wholesale trade, transportation and warehousing, non-durable goods manufacturing, and information. When indirect employment is included, nearly 18 million Americans are impacted by franchising with overall output of $2.1 trillion stemming from franchising amounting to 9.0 percent of private, nonfarm output.

Entrepreneurs of all sizes will be vital to its economic recovery, While there have been recent positive signs of economic growth, the employment picture remains weak. Small business owners including franchises continue to cite access to capital as a major concern. This paper will discuss many of the recent challenges faced by small business owner, ranging from cyclical worries about sales, the credit struggles which were exacerbated by the unique sources of this particular economic downturn.

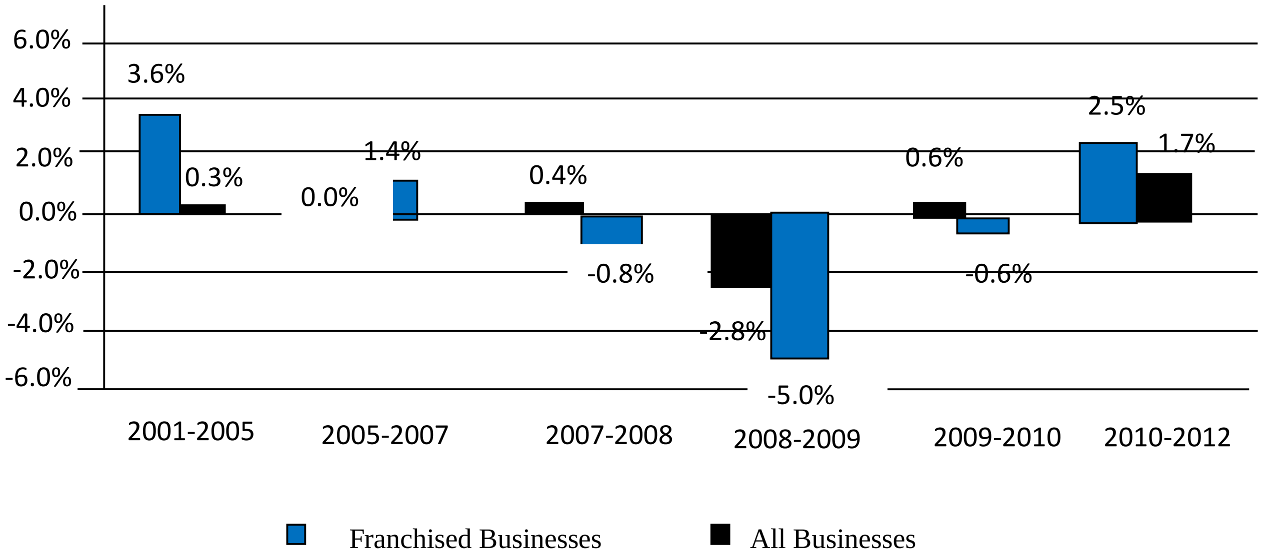
Most importantly, however, this paper will highlight how certain entrepreneurial ventures will propel America economy forward in the years to come, providing new sources of economic vitality and employment to our increasingly global market place. These high-impact businesses are sources of innovation and growth, and by scaling up rapidly, they provide a firm foundation for future stability (especially for their workers and local economies) and capture the collective attention of general public. These firms span a wide variety of industries and are geographically dispersed around the country. Small franchised businesses are an integral component of the high-impact firm landscape, as this write-up will show. The franchising business model provides the necessary resources for small business owners to scale quickly achieve long-term success.

Challenges in the Current Economic Environment

The U.S economy grew 3.1 percent in the fourth quarter of 2012, with real GDP also increasing 2.8 percent last year, lead by strong growth in personal consumption and net exports. After a rough economic environment the past few years, stronger economic data is a welcome sign. Despite the fact that the recession officially ended in June 2009, economic activity has been plagued by uncertainty and continued weakness, particularly in the labour market.

With that said, there are still a number of challenges for small businesses owners. First and foremost, entrepreneurs remain cautiously optimistic about a stronger economic climate. Poor sales remain a major concern for all small businesses, including franchised ones. While small business owners have higher expectations about hiring, capital spending, and sales projections than in previous surveys, economic activity is still below where it should be, and this newer optimism still needs to translate into *actual* hiring and spending activity.

Figure 1: Growth in Employment for Franchise Establishment and All Business Establishments, 2001-2012



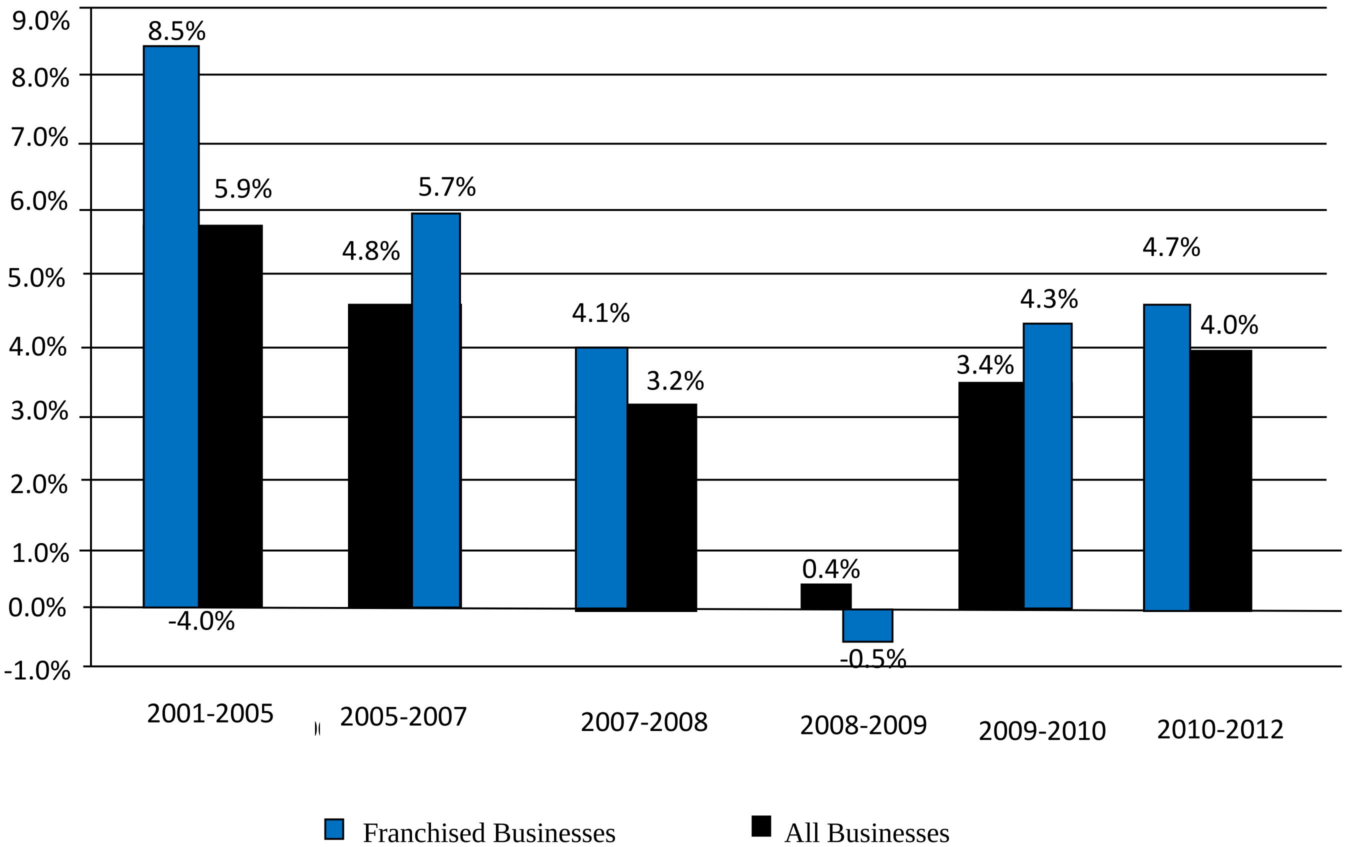
Source: PwC (2008, 2012a, b); Inform.
Note: The annual growth rates for all businesses include all private sector businesses in the United States and are not limited to those in franchise business format limes.

Sluggish employment growth will be a challenge for some time. Even with positive growth over much of the past year, there remain 7.5 million non-farm payroll jobs fewer today than at the end of 2012, and the unemployment rate remains around 9 percent. With stubbornly high unemployment, many policy makers have recognized the importance of small business for net job creation as a means of closing the "jobs deficit". On September 27, 2010, the President signed the Small Business Jobs Act, which increased SBA lending limits, included new tax provisions, promoted exporting, and established a new small business lending fund. Indeed, much of the impetus for the legislation and other policy moves has been to spur new hiring among small businesses, which traditionally have begun hiring sooner than their larger counterparts post-recession, but have not done so this time.

Much like the larger small business population, franchised businesses can be seen as engines of employment growth, especially in strong economic times. Data from the franchise economic impact studies conducted by Pricewaterhouse Coopers suggest that total employment in business format franchised establishments grew at an average annual rate of 3.6 percent between 2001 and 2005 (Figure 1). Such string growth coming out of the recession of 2001 contrast with the growth for all businesses, which averaged 0.3 percent per year over the four year period. More recent growth, given the recession, has been slower but still indicates a faster growth rate for franchised small businesses. Figure 1 shows the average annual employment growth rates from, 2007 to 2012. While all businesses declined rapidly during the depth of the recession in 2007 and 2008, franchised establishments recovered faster and have outpaced all businesses as a whole over the time period. Between 2010 and 2012, franchise employment is expected to grow 2.5 percent, compared to a 1.7 percent increase for all business, This is mirrored somewhat in the growth in output from franchise establishments, which is shown in Figure 2, over the same time period. Franchise business output is expected to grow by 4.7 percent between 2010 and 2012; whereas; the output from all business should increase by 4.0 percent.

Given these statistics, if we are to close the "jobs deficit," franchising must be part of the discussion. Ideally, franchise establishments would return to the growth rates experienced earlier in the decade. That means, of course that policymakers must address some of the challenges that franchisors and franchisees are facing, such as access to credit, which are dampening overall establishment and employment growth. This is perhaps best shown in Figure 2, which shows the average annual growth rates in output for franchise and all business between 2001 and 2012. The more recent growth rates are well below what was experienced between 2001 and 2005, where franchise establishments averaged output growth of 8.5 percent and the output from all businesses rose 5.9 percent each year.

Figure 2: Growth in output from Franchise Establishments and All Business Establishments 2001-2012

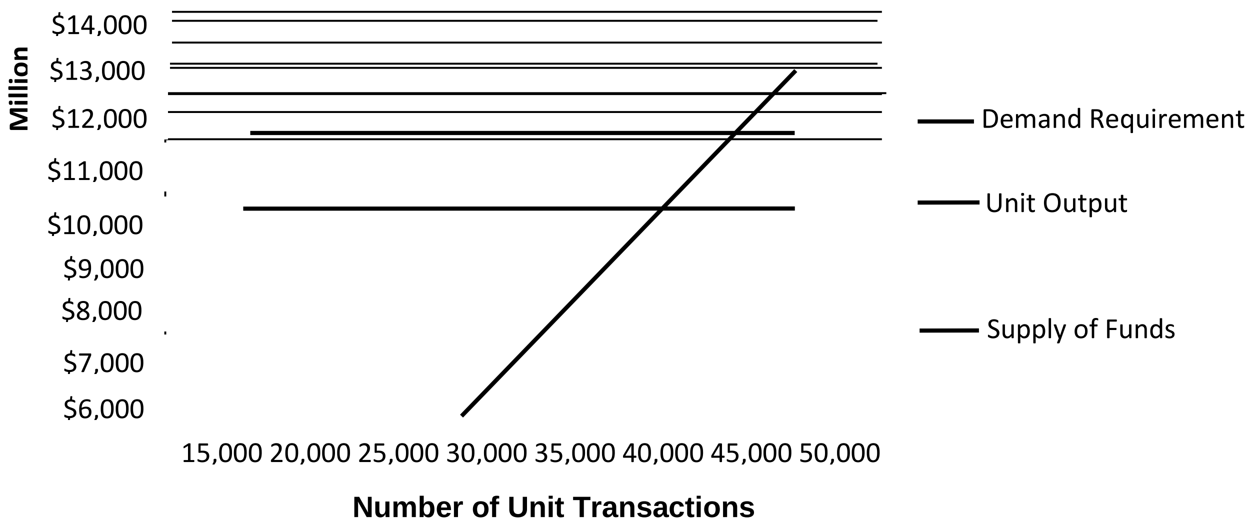


Source: PwC (2008, 2012a, b); Inform.
Note: The annual growth rates for all businesses include all private sector businesses in the United States and are not limited to those in franchise business format limes.

The International Franchise Association has referred to the lack of credit for its members as its" number one member issue" and one that is restraining franchised businesses' ability to grow. In fact, 39 percent of franchisees have been unable to obtain necessary financing. Moreover, 60 percent of franchisors report no improvement in credit access in recent months, which is slightly better than the 65 percent reported in the November 2010 - 2012 survey. In these survey, 42 percent of franchisors and 30 percent of franchisees stated that credit access issues significantly impacted their ability to grow their business in 2010 - 2012. To help to illustrate how credit is impacting their business, Appendix B shows some of the responses from franchisors and franchisees to the March 2012 survey.

Financing and credit, of course, are crucial elements to any business, and the recession and its continued aftermath have been painful for many. This experience is different from past recessions; Small business financing and credit have been constrained, both by tougher standards and by structural impediments due to the financial and housing market which were the roots of the economic crisis. In fact, small business loans outstanding fell 6.2 percent between 2009 and 2010, and the Federal Reserve Board's Senior Loan Officer Survey has reflected tighter commercial and industrial lending standards since 2007 and also weakened demand for lending overall. While recent surveys have shown improvement, the vast majority of senior officers reported no change in standards or demand.

Figure 3: Effect of Projected Lending Shortfall, 2012



Source: FRAN data (2012)

As a result of more restrictive lending conditions, small franchised businesses are competing in a much tougher environment for capital. FRAN data (2012) estimated that there will be a demand for over 41,000 franchise transactions this year, which is up 12 percent from 2011. Despite the uptick in demand, the report suggests that there will be a lending shortfall of more than $2 billion, which banks and the SBA may not be able to meet (Figure 3). This is not a trivial amount, as it represents nearly 8,000 franchise transactions. Under such assumptions, the lending shortfall would result in a loss of 82,334 jobs and $10.7 billion in economic output. Therefore, the access to credit challenge is significantly impacting franchised small businesses ability to grow this economy.

Small business lending challenges are being exacerbated by declining real estate values, limiting the ability of many owners to borrow. A recent NFIB survey found that nearly one-third of respondents felt that access to credit had become more difficult in the past twelve months. Among those who noted credit concerns, 29 percent of them cited poor sales and 25 percent mentioned business uncertainties as their biggest finance problem. Moreover, there were 15 percent of owners who did not borrow because they did not think that their loan application would be approved-the so-called "discouraged borrower". Depressed housing prices, low credit scores, and location (particularly in the most economically depressed areas) appear to influence one's ability to access credit , and when a small business approaches more than three lending institutions unsuccessfully, their chances for obtaining credit falls dramatically.

Small business owners also cite public policy and regulatory uncertainty as a concern, with new rules being drafted on health care, financial regulation, occupational safety, and the environment, among others. Each year, the compliance cost for new regulations is estimated at $1075 trillion, with smaller firms with less than 20 employees paying 36 percent more in compliance cost per employee than their larger counterparts. Recognizing that the rulemaking process can be burdensome for all businesses – especially small ones – the President recently signed Executive Order 13563 which instructed agencies to adopt rules with the least burdensome approaches, taking into consideration the benefit of the regulations and the best available scientific evidence. This directive also instructed Federal agencies to review existing regulations.

Entrepreneurship and Net Job Creation

The economic downturn has highlighted the need for new economic engines of growth. Given the loss of over 7 million jobs, many policy makers have looked towards entrepreneurship as a mechanism for generating new employment, innovation, and competitiveness. Most American, in fact, see business creation and entrepreneurship as the best way of growing the economy and creating new jobs, and they suggest that government should do more to encourage individuals to start their own businesses. This view is shared by politicians of both parties, all of whom espouse the belief that "Main Street" businesses benefit our overall economy. President Obama recently said the following on the importance of the entrepreneur:

> Entrepreneurs embody the promise of America: the belief that if you have a good idea and are willing to work hard and see it through, you can succeed in this country. And in fulfilling this promise entrepreneurs also play a critical role in expanding our economy and creating jobs.

The White House has also introduced a new organization, the Startup America Partnership, to help promote entrepreneurship.

Research on the role of small business in net job creation is the main impetus behind these initiatives. The notion that small businesses generate most of the net new jobs has become commonplace and part of the lexicon of speechwriters everywhere. Behind this statistic is a consistent theme: new ventures are essential in our dynamic economy to maintain our competitiveness, to generate new economic growth, and to produce new employment.

The Ewing Marion Kauffman Foundation has said that start-up, most notably those firms that are less than five years old, are key to net job creation, and public policy should therefore focus on the entrepreneur. They find that start-up have been the primary drivers of net employment changes since 1977. Indeed, some economists argue that the size of the business is really not the contributing factor; instead, studies should focus more analysis on the age of the firm. Young startups account for 3 percent of the total employment in the country but represent 20 percent of the gross job creation. While new firms shed employment rapidly, with 40 percent of the jobs initially created at startup lost after five years, these young firms tend to grow more rapidly than old firms and generate more net new employment overall. Much of this is a function of the fact that young firms represent such a larger proportion of all businesses at any given time, building in a structural advantage for newer firms to generate more net new jobs.

Other studies show that age of the firm is more indicative of growth than the size of the firm, with more mature businesses being the driving force. High-impact firms, according to one recent study, are those that have doubled their sales and had their employment growth quantifier at least double over the most recent four–year period. This research has found that the average age of a high-impact firm was 25 years old between 2002 and 2006, and perhaps surprisingly, these firms were in every major industry and were located across the country in every state, region, and country. Identify and cultivating these firms, which changes over time, and allowing them to flourish is the key.

In order for a business to succeed and generate new employment, though, it must be able to navigate a difficult competitive landscape and to scale up to effectively meet growing demand. This is often difficult. Firm which last four years have often passed a significant threshold on their survivability? For those businesses that are successful, transitioning to a "second stage" of their life cycle brings tough financial, management, and logistical challenges which many novice entrepreneurs are not ready to tackle. Policies geared toward start-ups are not as helpful, and therefore, new initiatives might need to be undertaken to nurture this small but economically vibrant group of businesses. Florida provide an excellent example and test case for this approach, as its legislature in 2009 created an Economic Gardening Institute at the University of Central Florida that provides counseling and other services to fast-growing businesses. Similarly, the Kauffman Laboratories for Enterprise creation recruits and provides technical support to top entrepreneurs to help make their ventures successful.

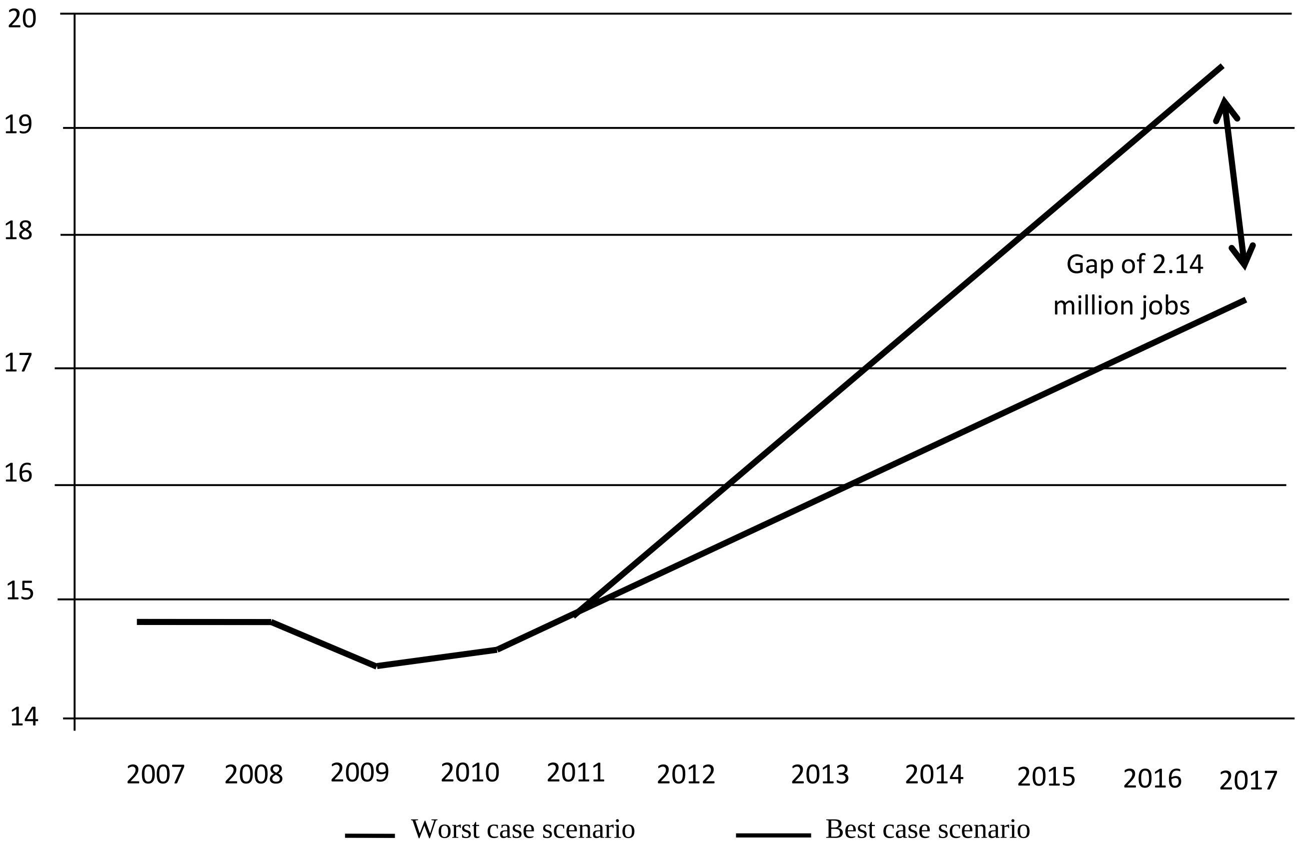
The Franchise Business Model Provides Scaling Advantages and Generates Job

Franchising provides another method of scaling up quickly providing new entrepreneurs with proven techniques and tools to move to the "second stage" with the right tools. Research, for instance, has shown that franchising can enhance a firm's survival and growth, especially for these franchises that grow most rapidly in their early years. Indeed, a franchisors' growth is highly dependent on its prior performance, and as such, it is important to establish oneself at the start-up phase with strong resources and an orientation for success. When doing so, the franchise business model can provide an important mechanism for quick scalability and, under the right circumstances, to outperform their non-franchise counterparts. A few past studies have found this to be the case. Spinelli, Birley, and Leleux (2003) observed that U.S public franchises bested the Standard & Poor 500 returns in nine of the ten years that they studied, and Aliouche and Schelentrich (2005) provided evidence that franchised restaurants had greater market value than those which were not franchised.

Earlier in the paper, it was suggested that franchised establishments need to be part of the discussion when it comes to overall employment and output growth in the U.S. While these data are not perfect comparisons, it does provide some clues – especially in terms of relative growth rats – about the importance of franchising as a sector in generating net new jobs. Indeed, it suggests that there might have been some "high-impact" franchises during this period. In most of the sectors, franchise establishments had higher or comparable employment growth with their non-franchised peers.

One of the primary findings from Figure 1 is that even during the recent economic downturn and period of tight credit; employment growth in small franchised establishments has outstripped the growth of all other businesses. This helps to support the claim that franchising is relatively resilient, both in good and bad economic times, at generating jobs and output (Figure 2). In the good times, when credit is flowing and the economy is booming, franchisors and franchisees have said that the lack of credit has hurt their ability to grow their business. Figure 1 and 2 also show us this, as tight credit conditions stalled both job and output growth between 2007 and 2009.

Figure 4: Project Franchise Employment Growth under Different Credit Scenarios, 2007 -2017
(Cumulative Effects on Direct and Indirect Employment from Business Format Franchises, in millions)



Source: Authors' calculations using data from PwC (2008, 2012a, b).

Looking ahead, franchising should be part of any discussion on employment and overall economic growth, especially in light of the before-mentioned "jobs deficit". Figure 4 illustrates this point by showing the potential growth I franchising under different scenarios through 2017, or ten years beyond the Economic Census data. Under the best case scenarios, we will assume that credit is readily available, with franchisors and franchisees lending needs being fully met. The other scenario, which is more pessimistic, is one where credit conditions are tight. With each successive year, we can see the cumulative impacts of growth under each scenario.

Both historical and current data are used to derive the two scenarios forecasts in Figure 4. Suffice it to say that these are rough estimates, both because these are such uncertain economic times and because only limited data exist on annual employment in franchising. For both scenarios, estimates for employment growth from the Economist Intelligence Unit (EIU) were used for 2011 to 2017. For the best case scenarios, where credit is available and the business conditions are favorable, we have consistent data for franchise job growth from 2001 to 2005. During this period, job growth in franchising outstripped the growth in total U.S jobs by 3.3 percent each year. If we were to apply a similar "premium" to the EIU forecasts for 2011 to 2017, direct and indirect employment in business format franchising would grow by over 5 million.

In contrast, the more recent experience of tight credit (2007 to 2012) illustrates a period when credit conditions were less favourable. The resiliency of franchising, however, enabled franchised small businesses to grow faster, or shrink less, than other U.S. businesses. During this time span, franchising grew 1.3 percent better than other firms on average each year. To continue our example, under the worst case scenario if we were to add a 1.3 percent "premium" to the EIU estimates for employment growth between 2011 and 2017, overall direct and indirect franchise employment in business format franchising would grow by almost 3 million.

In sum, the franchising industry has and will continue t be a significant contributor to job creation. With a positive business environment, which includes access to credit but might as encompass a favourable tax and regulatory climate and a growing economy, small franchise establishments can help to close the "job gap" that currently exists due to the severity of the 2007-2009 economic recession. Franchise alone, assuming the best scenarios presented above, could help close the gap be adding over 2 million jobs more than if the economic environment over the next six year is closer to the tight credit scenarios. This simulated exercise demonstrates the true potential of franchising as an economic engine under ideal circumstances and it highlights the need for greater credit access to franchisors and franchisees moving forward.

Franchising Opportunities and Global Competition

Another avenue for job creation and economic growth is through increased trade. The President has said that he wants to double U.S. export by 2015, creating the National Export Initiative (NEI) by Executive Order 13534. To achieve the goal of exporting $3.1 trillion of goods and services by 2015, the Administration plans to focus n five areas:

- Improving overall trade promotion of U.S. goods and services abroad
- Increasing access to export financing, especially for small businesses
- Removing barriers to trade
- Enforcing existing trade rules
- Promoting "strong, sustainable, and balanced growth" globally

Some of these components are more challenging than others, but highlighting the importance of this initiative, it was singled out in the FY 2012 budget for continued financial support and a large number of Cabinet-level officials and their staffs have been devoted to this cause for much of the past year.
International markets provide domestic franchisors with tremendous opportunities for growth. While GDP is expected to grow around 2.5 percent in the advanced economic – including the United States – this year, economic growth in emerging markets is forecast to expand around 6.5 percent. In promoting the NEI, the U.S. Department of Commerce writes the following:

> 95 percent of the world's customers lie outside the United States; we ignore them at our peril. Tapping into customers in fast-growing markets abroad and in

> our traditional markets is crucial to putting the United States' own economy on a solid footing – and generating the demand needed to put Americans back to work. We cannot return to an economy that is driven by borrowing and consumption. To maintain robust growth, the world will need to rely less on U.S. consumption – and we will need to sell more to the rest of the world.

Indeed, franchised small business have been doing just that, providing new franchisee opportunities abroad and drivers of new employment and growth for franchisors.

Recently, the Subway sandwich chain overtook McDonald's as the world's largest restaurant chain in terms of number of units, with a lot of press attention. (McDonald's still dominates all restaurants when it comes to sales revenue). In reading through these stories, though, it is clear that Subway's success stems from its growth overseas. While just over 70 percent of its stores operate in the United States, its current growth and long-term expansion plans lay elsewhere, particularly in Asia, where it will open its 1,000 location, and other emerging markets, It is not alone, according to the *Wall Street Journal.* "Starbucks Corp. recently said it plans to tripe its number of outlets in China, for example. Dunkin' Brands Inc., parent of Dunkin' Donuts and Baskin-Robbins, plans to open thousands of new outlets in China in coming years as well as its first stores in Vietnam in the next 18 months.

Clearly, the franchise model provides scalability an growth globally, which helps to create high-paying jobs in the U.S., particularly at the franchisor's headquarters. Indeed, international expansion often requires highly-skilled professionals who are capable of navigating complex country-by-country legal and regulatory frameworks and who can help to custom tailor a company's product or service to cater to local tastes.

Further, the expansion of U.S. franchise businesses abroad can directly help the U.S. international balance of payments. This is a powerful benefit because the U.S. has run trade deficits for the past three decades. Payments from franchisees abroad flow into the U.S. as they pay their royalties to U.S. franchisors. Of course, such royalty payments increase with a growing global economy, and for U.S. franchisor to be able to pursue international opportunities, they must have the resources domestically- readily-available credit access and favourable business conditions – to make such global expansions a reality.

Concluding Remarks

Franchised small businesses are an integral part of the economy, generating employment and output at rates faster than all other businesses. Indeed, the franchise business model provides key resources to entrepreneurs wishing to open their own establishment, and it allows for these business owners to scale up quickly. Such advantages help franchisees and franchisors weather even difficult times. This year, business format franchise output is expected to grow 4.7 percent, with employment up 2.5 percent, outpacing all other businesses by 0.7 percent and 0.8 percent, respectively, even during the recession of 2007-2009, franchised businesses weathered the downtown better than many other businesses. For that reason, it will be important for policymaker to make franchising part of the discussion when pursing solutions to grow this economy.

Under the right business conditions, franchises should franchise. If we have the right mix of tax and regulatory policies, a growing economy, and sufficient credit for franchisees and franchisors, franchise employment could grow substantially over the course of the next few years. However, if these conditions are not met, franchises will not be able to grow as rapidly, nor will any small business. More recent experiences, for instance, bear this out. Growth in employment and output since 2007, when credit conditions have become tighter, is far below what it was between 2001 and 2005. If we could return to those earlier growth rates, we could help to close the "jobs gap" by employing more Americans.

Of course, challenges continue to prevent that from happening. Access to credit, while improved from its recessionary lows, is still a problem for many business owners. In a recent survey, 39 percent of franchisors suggested that at least half of their existing or prospective franchisees had been unable to obtain necessary financing. Moreover, FRAN data estimates that there will be a $ 2 billion shortfall in lending to franchises in 2012, with the demand for loans exceeding the willingness of banks and other financial institutions to supply them.

It is for this reason that the International Franchise Association has deemed "access to credit" as its number one issue. FRAN data (2010) found that $ 1 million in lending to franchised businesses creates or sustains an estimated 40 jobs and generates an estimated $ 4.2 million n economic output. Increasing capital flow to the franchising sector can have a very positive impact on the pace of the U.S. economic recovery. Likewise, constrained capital flow will have a negative impact and will slow the rate of the economic recovery. While government has introduced innovative, and often temporary, solutions to help rectify this problem, the franchise community should work on long-term structural solutions in collaboration with its lending and other partners to ensure adequate business capital moving forward.

In closing, this paper has helped to establish the important role that franchises play in the American economy which is among developed economies in the world today. Despite the economic challenges of the past few years, business owners are more optimistic this year than last, and franchising remains a viable option for many entrepreneurs wishing to pursue the "American Dream". These franchised small businesses will offer innovative new products and services to consumers. Many of these entrepreneurs will also open up new opportunities for growth by pursuing new markets overseas. Undoubtedly, the future of franchising looks bright, especially if the business environment provides a fertile ground for these firms to proper and grows.

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