Do Absentee-Owner Franchise Business Models Really Work?

By Jack Pearce, CFE

What is an Absentee-Owner Concept?

In the world of franchising there is a concept known as an "absentee owner" business model. The idea is you invest in the ownership of a franchise unit but your personal, daily involvement in the business is not necessary in order to succeed. The ideal of a no-input-required investment may be ok for highly diversified mutual funds, but it is rarely a good idea when it's your hard earned savings at risk in a single commercial business location. This is especially true in today's very competitive retail market place.

Speaking of very competitive market places, the competition for selling those very same new franchise units to investors just like you is a very tough sell. For example, there are roughly 4,000 franchise concepts currently offered and sold in the US today and in aggregate they sell an estimated 14,000 new units per year or 3.5 units per concept. Considering some of the major, nationally recognized name brands sell hundreds of new units every year this means emerging and smaller brands may struggle to make only one or two new unit sales per year.

With such fierce competition just to find these buyers there is a temptation to position the opportunity as an absentee owner concept. This provides the sales rep with a substantial carrot to offer the buyer, "simply make the investment but you don't have to commit your time." This is not to say there aren't perfectly legitimate absentee owner concepts in the market. It just raises the specter of a sales person over emphasizing this benefit when it may not actually exist.

The Importance of Performance Responsibility

One of the first and most important matches a potential franchise investor makes is to find the appropriate business concept to meet their various lifestyle choices. After all, running your own small business or franchise unit is hardly ever an easy task and like everything else rewarding in life it requires a lot of time and effort. For example, a retiree heading into their "sunset" years may not be interested in a business requiring a lot of hard work. Instead, they are just looking for something with a solid return on investment with little or no time commitment.

So, the absentee owner concept seems like a really good idea, right? Just put in your money, invest very little time or effort and voila, you get back a great return on investment. The only problem is this outcome rarely happens, if ever. There are at least two very important reasons why absentee owner and franchise business models don't mix. One is the implied release of performance responsibility and two is the principle of protecting one's investment.

Performance responsibility in franchising is a fairly complex subject, but let's see if we can make it simple for this example. A franchisee's number one responsibility is to develop market share for the brand in their respective territory granted in the franchise agreement. In order to achieve market share and individual unit profitability the business must operate successfully according to the model outlined in the Franchise Disclosure Document (FDD).

Now combine the thought above with the absentee owner concept. Is the franchise business unit going to operate so autonomously and so successfully there is no need for the owner/franchisee to be involved on a daily basis? All the sales and marketing, customer service, administration and operations are going to function seamlessly with employees simply doing their job at peak performance. Of course, this seems highly unlikely and here's a case study to illustrate the point.

Case in Point

On an emerging franchise company's website it proclaimed "For investors, one of the great things about [this business model is it] offers investors a semi-absentee franchise model. Franchisees can maximize the revenue they generate… while only needing to work a few hours a week." This statement sounds very tantalizing to our retiree buyer looking for a solid investment, while at the same time not requiring involvement on a day-to-day basis.

But, there is a catch! This business model and its success depend heavily on a single, key employee with an unusual range of skill requirements. The FDD does an excellent job of describing this key employee, articulating the critical attributes and even offers extensive recruiting and training support to further develop this employee. But what the FDD did not disclose was how difficult it is to find this key person in the local market. Now what?

Most franchise professionals would respond "the franchisee needs to step in and take over this key role until they can find a suitable employee". Ok, the advertising said the absentee owner would only have to work a few hours a week, but now they are forced into a position working 40 to 50 hours per week just to keep the business afloat. They find themselves working hard with little or no time to recruit, hire, train and manage a suitable replacement, not to mention they struggle to follow and execute a business model they never thought they would have to operate.

Protecting Your Investment

Here is the second reason why franchising and the absentee owner don't mix. Typically, investments are thought of in terms of stocks and bonds and the buyer does not need to know anything about the company in which the money is invested. In franchising, the business **IS** the investment and if you are going to protect those funds you better know something about the concept. Our example franchisee above is now stuck inside their business and may not know a whole lot about how to make it successful or even run it on a daily basis.

On top of being forced into the daily operations of the business the franchisee/owner also discovers a fundamental truth about franchising. Even though the FDD disclosed everything you could possibly need to know about the business model, it cannot predict how well your skills and experience will translate into performance. This is where you DON'T want to look back in hindsight and discover you do not personally have the appropriate skills or experience it takes to succeed in this particular industry or type of business.

The Moment of Truth

The franchisee/investor believed from the very beginning they were buying into a cash machine that would simply churn out profits with little or no effort on their part. After all, that is what they were sold, an absentee owner concept. They carefully read the Franchise Disclosure Document and the Item 19 clearly represented a $45,000 to $50,000 total payroll cost to support the single, key employee promise. Unfortunately, the franchisee soon discovered this dual-faceted position requires two mutually exclusive skill sets and the key employee promise may be nearly impossible to fulfill in a single person at the disclosed salary level.

What does this mean for the desperate retiree investor who is now committed to daily operations and searching for a way out? In a typical entrepreneurial world it means you either step-in, solve the problem yourself or begin to position your franchise unit for resale to the next interested investor. At the same time, it does not mean you have to deceive the potential buyer you just have to adequately disclose what it truly takes to make this opportunity work.

The initial absentee owner statements on the website gave you the impression you would be free from most performance responsibilities. At that point you should have asked yourself, "If this is true, then why not just invest my money in the stock market where results are more predictable?" It would appear in this case the absentee owner claim is similar to the "free lunch" myth in that there is no such thing. Ultimately, this business like almost all others requires hard work and personal involvement from all parties, both owner and employees.

The Moral of the Story

The lesson learned in this situation is to be extra cautious about the expression "absentee owner". The franchise organization (franchisor) should have been extra careful in using the absentee positioning as a key selling point and not over emphasizing the lack of involvement. The investor/buyer should have been disclosed about the importance of prior knowledge and experience in order to protect their investment should they have to run this business themselves. In other words, if this business is driven by one key component then you better be well equipped to perform this critical function yourself.

An old saying comes to mind in this situation and that is "it takes one to know one". If you are a franchisee investor attempting to run a new business for the first time you don't want to be completely naïve about exactly what it takes to make this particular business a success. If you can't find that single employee with the strange combination of miss-matched skills, then your business investment is going to rest on your own shoulders and you will have to take sole responsibility to make it work.

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