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This sample is a somewhat esoteric business article I co-authored with Jean-Louis Janssen when we worked together as consultants in the franchising field. The extensive piece covers a range of strategic and practical issues pertaining to conversion franchising and was oriented toward the convenience retailing field.

ISSUES IN CONVERSION FRANCHISING: AN EXAMPLE

by E.Todd Ellison and Jean-Louis Janssen

SYNOPSIS — Conversion franchising is one of the most powerful business tools ever created for rapid growth and brand building. Here we explore some of the "ins and outs" of conversion franchising as applied to the gasoline and convenience retailing industry. The sidebar ***How Size Matters*** illuminates some hidden potholes in designing a retail franchise opportunity, while the sidebar ***Coping with the Entrepreneurial Factor*** sheds light on some of the relationship issues that corporate franchisors can encounter.

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This example of "doing conversion franchising right" is drawn from the gasoline and convenience retailing industry.While this industry has its own quirks, the principles, rationales and strategies for using conversion franchising are not dissimilar from other industries.

The fuel distribution systems of major oil companies are a variation of what we call the "first wave" of franchising, the "trade name" franchising concept that began to revolutionize marketing in the 19th century. The "second wave" of business format franchises (BFFs) that has grown so remarkably in the last half of the 20th century added new income-generation components (like royalties on sales) to first wave franchising mechanisms. Recognizing the potential benefits of BFFs, several oil companies have crafted new c-store concepts and offered them to dealer and jobber/distributor networks as business format franchises. While dealers and jobbers have not widely embraced these offerings so far, this form nonetheless offers great potential benefits for both franchisor and franchisee when properly conceived and executed.

The Need for Franchising

Yes, need. Franchising new convenience retail offerings makes excellent business sense for oil companies: new royalty income, new franchise fee income and advertising fund contributions are the economic motivations that get the most play. But new franchised offerings may also have more "curb appeal" to attract new customers and compete more effectively against other retailers offering much the same stuff. The new offerings are also usually bigger facilities (see the *How Size Matters* sidebar) capable of greater revenue generation. Taken altogether, a franchised offering is a powerful new tool for revenue generation and brand propagation, and one that is capitalized and promoted with franchisee investment.The rationale for franchising in oil company distribution systems is persuasive; no other structure of business relationship can achieve these ends so effectively and so rapidly.

For many oil companies, being

able to grow the proportion of higher profit non-fuel sales has also become an important objective. In fact, this is a publicly-stated, long-term downstream goal of a number of major firms in the industry. The rub is that truly cashing in on the strategic promise of convenience retailing for oil companies will only be achieved through franchising in one form or another. The reasons lie in an oil company's class of trade mix.

In most oil company distribution systems, far less than half of the retail outlets are company-owned. In some cases only 10 percent or fewer of the branded outlets fall in this class.These are the only units in which a new retail offering can be implemented by corporate mandate: the rest must be developed by others, dealers and jobbers/distributors who must choose whether or not to make the sizeable investment such offerings typically require.

What are the prospects for building a brand with only a handful of company-owned operations in a given market? How much of an impact will this have on system-wide profits? Without royalty revenues and advertising fund contributions from franchisees, the overall impact on profits is not likely to set any new records.

Further, skeptics might find it difficult to imagine how the investment in creating a new branded convenience retail offering can be justified by the potential returns from just company-operated units.And in most systems, the kinds of large facilities being showcased cannot be built on most existing fuel retail sites; thus they are likely to appear in full bloom on only a small percentage of current branded sites. Clearly, developing a new brand for such a small piece of the overall reservoir of branded sites is likely to be an expensive proposition. Most companies would like to see their new brand grace a much higher percentage of total sites. Looks like a case for franchising.

As we mentioned earlier, recent franchised c-store offerings have not exactly been a smashing hit with dealers. Nor with the jobber/distributor segment. Oil company franchisors have experienced difficulty in getting their dealers to "get with the program" and sign up for their business format franchise offerings in significant numbers. Why? "Franchising just doesn't work," is one answer we've heard. In fact, nothing could be further from the truth. What is true, however, is that selling a new c-store franchise brand to experienced business owners — existing dealers and jobbers in this case — demands a well thought out, well executed program that's a clear win-win for both sides.

The Challenges

Doing c-store conversion franchising right begins with a thorough understanding of what the real challenges are. In a nutshell, they are designing the right offering (think of it as a business and marketing system) and then selling it to prospective franchisees.

Consider the calculations an existing dealer must make to economically justify taking on a new franchised c-store offering. Setting aside any up-front fees, on an ongoing operational basis he must be able to anticipate enough lift in sales to justify the royalty payments and advertising contributions called for by the franchise agreement. In addition, the franchisee must be able to plug in a return on his capital investment in a new facility and equipment, plus figure on being able to cover any additional operating costs that may be required by the new business system. And, of course, this analysis leads into other factors, such as potential lost sales during construction and the term of the franchise agreement, which needs to be long enough for the franchisee to be able to recoup his investment and make a reasonable return on capital.

If a prospective franchisee cannot make these calculations come up positive for him, there is little hope that even the sexiest, most attractive c-store offering will become a successful franchise business. Fortunately, there are tens of thousands of franchisees and franchisors who have made this math work in a win-win setting.

Successful conversion franchising (we'll get to the "conversion" issue shortly) demands that the franchisor be able to stand in the shoes of the prospective franchisee (see the sidebar *Coping with the Entrepreneurial Factor*). Otherwise, no sale. And enough "no sales" essentially means no new retailing revenues or increased fuel sales, and thus no increased profits from this necessary segment.

Conversion: It's Not Like McDonald's

"Conversion" in the lexicon of franchising, simply means persuading an existing business owner to "convert" to being a franchisee. As we saw in the preceding paragraphs, oil companies wishing to sell new c-store franchises must "convert" their existing dealers and jobbers/distributors to being franchisees of the new offering. Franchisors like McDonald's are geared to new entrepreneurs: they don't attempt to "convert" the owner of Joe's Diner, for example, to being a McDonald's franchisee.

As you might imagine, there is a huge difference between selling a franchise to an experienced business owner versus selling to someone who is new to business ownership and usually new to the franchisor's industry. The vast bulk of franchisees comprise the latter case: they are usually making the transition from being employees to being business owners — franchisees. Their level of dependency on the franchisor's "package," expertise and support services is very high, particularly at the outset. Contrast this with an existing gasoline dealer in a major brand setting.

In all probability, this dealer has been operating some kind of convenience retailing business for several years. Typically,

How Size Matters

How much bigger is actually better? This is one of the questions many convenience retailers are wrestling with at the present time. For oil companies who have — or are considering — a BFF convenience retail offering, the size of the facility can significantly impact its franchisability. Offerings need to be sized for the franchise customer as well as for other important considerations.

Competitive issues and revenue generating capability have played a big part in the move toward larger facilities, as have the natural evolution of g-store and c-store concepts and market factors like "channel blur." Yet the "right" size will probably turn out to be a number of "right sizes" after certain realities set in.

Too big can be dangerous from a franchising perspective. Excessively large facilities obviously cost more to build and require more real estate, factors which may cause the offering to exceed the investment thresholds of many conversion candidates. They may also be more costly to operate and be more location sensitive, factors sure to give savvy operators pause before they decide to sign a franchise agreement. Large sites in desirable locations are also increasingly scarce and the bulk of existing gas station sites cannot accommodate most of the larger 3-6,000 square foot designs we have seen. For a company wishing to achieve significant market penetration, size and cost issues will have a major impact on the ability to convert existing dealers to franchisees.

"Critical mass" is another factor in the size equation. Let's say an oil company with a new franchised c-store brand is planning how best to roll out the brand to the public. A key factor will quickly surface: the number of units of the new brand in the rollout market. If only large and expensive facilities of the new brand can be built, achieving advertising critical mass may be next to impossible: too few sites flying the new brand to make a brand launch campaign really pay off. Thus, achieving market penetration goals (and targeted customer counts) may also be next to impossible.

However, if the new brand facility can, say, be sized to include "junior" versions that will accommodate far more of the existing branded sites in the market, then the advertising picture makes much more sense for all: consumers, franchisees and the franchisor.

Rollout stakes are high: if the initial rollout market cannot achieve a high degree of conversion, the chances of succeeding in subsequent rollout markets become increasingly tough.

The real point of this discussion, however, is not optimum facility size; it's about the need to carefully consider issues like size, cost, design and brand development strategy in the larger contexts of franchisability, market penetration and competitive realities. Retailing revenues and profits are at stake.

Coping with the Entrepreneurial Factor

It's no secret that there's a natural tension between large, long established corporations and entrepreneurs. "Doing franchising right" requires the franchisor to truly understand what motivates people who invest their own money in a business opportunity such as a dealership or a franchise, rather than continue working for somebody else for their entire working career. Since most existing franchisors have grown up with franchising realities, they have usually managed to maintain some level of contact with their own entrepreneurial roots. This "entrepreneurial memory" enhances their ability to sell to, communicate with and provide for the support needs of franchisee entrepreneurs — even though the franchisor might now be a large, bureaucratic company itself. For large companies getting into business format franchising for the first time, however, the culture disparities can be challenging.

It is only realistic to acknowledge that people who have spent most of their working lives primarily in large company managerial settings may have some difficulty in designing and administering business offerings and support systems that must meet the real needs of entrepreneurial franchisees. Succeeding in a corporate setting often demands very different skills than those required to survive and prosper on the retailing "front line" over time. Numerous factors, from risk and uncertainty tolerance to expectations and goals, personality types, social skills and even patience can be at variance. And retail entrepreneurial types know that their income is a direct result of getting people to spend money at their stores. Many corporate management personnel, however, are necessarily far removed from retail customers, having spent their careers moving from position to position along the "corporate ladder" to gain experience in a variety of facets of company operations, few of which have anything to do with retailing. And their distance from customers usually increases the higher they rise in the company.

One way of minimizing potential difficulties is to involve a variety of non-corporate outsiders during the process of developing the offering and the administrative and compliance functions that go along with a franchise. This provides ongoing entrepreneurial "reality checks" before the business offering is fully baked. A more radical solution is establishing a separate business unit to operate the franchise entity, a unit structured to be able to operate more like best-in-class franchisors.

Actually, the potential culture clash can be an opportunity in disguise if corporate franchisors elect to use the franchising process to learn to act more entrepreneurially themselves, an organizational challenge that many large corporations are currently attempting to tackle. For such companies, franchising can become a sort of entrepreneurial laboratory as well as a source of new revenues and profits.

he has paid no royalties on his gross sales over this time, nor has he contributed a percentage of his sales to an advertising fund, since none are customarily required by his agreement with the oil company. Presumably, he has experienced some degree of success over this time. Perhaps his g-store or c-store business hasn't been a stellar performer, but at least in his mind he knows the business: he's an expert. Selling a franchise offering to such an expert is vastly more challenging than selling to an entrepreneurial "newbie."

Selling a franchise offering to jobbers/distributors can be even more challenging. Many of these firms are excellent convenience retailers in the markets they serve and some are even developing their own store and food service brands. What can a supplier's c-store brand do that their own brand cannot? And what would induce them to trade independence and full control over their business for a seemingly more constrained franchise relationship?

Despite these hurdles, persuading experienced business owners to "convert" to a franchise system has been done very successfully by numerous franchisors. Century 21, for example, completely turned the real estate brokerage business on its head using the conversion franchising method. H & R Block created an entire new industry by converting bookkeepers and accountants into franchised tax preparers. Conversion is now a widely-used strategy in franchising.

The trick in successful conversions is not really a trick at all; it's just doing most of the right things right, beginning with the design of the offering — the brand, the business system and the marketing machinery that will bring new customers and new profits in the door for both franchisee and franchisor. And, of course, designing an effective process for selling the new offering to prospective franchisees.

The Offering: Brand and Differentiation

Fundamental to franchising is the immense marketing power of a strong brand. Despite some well-publicized predictions of the death of branding during the early years of generics, America — and the world — is more brand-conscious now than ever before. And if underlying behavioral and demographic patterns continue, we will become even more brand-conscious in the future, rather than less. Branding works.

A strong brand is a shorthand symbol for a whole host of perceptions consumers have about a particular business. A strong brand is also a symbol for trust and trust keeps customers coming back. Trusted brands simplify decisionmaking, something that ever-busier people in an ever more complex world are always seeking. Brands make decisionmaking more convenient. And as we know, real convenience sells (along with perceived value, savvy pricing and many other components of good merchandising practice).

The brand phenomenon has played a major role in the explosive growth of franchising over the last fifty years. Being able to have a "piece" of a brand that consumers respect is the major attractor for many prospective franchisees; the same attractor that has built today's major franchise systems, including those of the oil companies. Brand is no less important in convenience retailing than in food service or tax preparation or real estate sales. In fact, it may be more important because of intense competition and the lack of truly proprietary components in the bulk of current c-store offerings.

It has been said that "a c-store is a c-store is a c-store." One of the tasks of designing a franchised c-store offering is to build in some kinds of customer attractors that separate it perceptually from other c-store offerings. Any such differentiating qualities must, of course, be understandable and valuable to both the target retail customer and also to the prospective franchisee (who, as we have seen, is typically an experienced c-store operator to one degree or another). Is a "bigger box" an adequate differentiator? What about non-exclusive co-brand relationships with QSRs? Or proprietary house brands? Or the design and cost of the box and related improvements? Or pricing policy? What customer needs does the business solve in a unique way? These are the kinds of questions the would-be franchisor needs to carefully consider in formulating a convenience retail offering that can become a successful franchise for many years into the future; an offering that can evolve to meet new competitive challenges and consumer needs. The evolution issue may be worth underscoring: a great franchise system, like a great steak, is never fully cooked.

With rare exceptions, powerful retailing brands are built market by market using a process fueled by advertising. This is particularly important in the c-store business where there is precious little that differentiates competing brands. Trying to sell a new branded c-store franchise without a strong advertising component falls in the difficulty range of exceedingly-tough-to-hopeless. It's even tougher when the c-store brand can't or won't piggyback on the long-established strength of the parent oil brand, a situation that is occurring more frequently in the past few years in response to certain consumer perceptions about oil companies as convenience retailers and QSR outlets and recent, brand-muddying mergers. Prospective franchisees ask themselves what will drive new customers into their new stores (once the novelty factor wears off) if it isn't advertising.

Advertising is a powerful benefit of a good franchise program, but one that prospective conversion candidates often need to be educated about. In the oil industry, many existing gasoline c-store brands have historically received very little advertising support: traditional tradename franchise agreements usually don't require dealer/jobber advertising contributions. The entire advertising investment was shouldered by the supplier, who in the past most often saw the store as just a small part of the overall brand offering.

A well-designed conversion franchise program changes this equation and gets the entire system participating in advertising programs that can make a major difference in launching and sustaining a new brand in today's highly competitive retail environment.

This huff and puff about advertising is not to say that it's necessarily the main component of a successful franchise offering. But it's important to prospective conversion franchisees and it should also be very important to oil companies who are seriously intent on propagating a new c-store brand throughout their distribution system.

Agreements as Opportunities, Not Obstacles

We have heard some in the industry express fears of the nitty-gritty legal side of franchising: the franchise agreement and the required documentation that goes along with it, such as the Uniform Franchise Offering Circular. In some minds, the need for such legal documentation is regarded as a negative. In reality, quite the opposite is true. A well-crafted franchise agreement affords superior protections to the franchisor and often encourages a higher level of system performance than oil companies are accustomed to expecting from agreements crafted to comply with PMPA. Franchise agreements are integral components of the business system and great care should go into their development, including systematic consideration of the compliance enforcement mechanisms that are essential for ensuring that brand equity is preserved and enhanced for the entire system.

An important dimension of system performance in franchising — and thus brand equity — is consistency: in quality, in service delivery, in customer satisfaction, in brand representation. Consistency requires standards, and maintenance of standards is a core issue in franchise agreements, something that has not been nearly as well implemented through traditional PMPA-driven agreements we've seen.

Good dealers and jobbers recognize the importance of standards and they support — rather than resist — higher standards. In our interviews with dozens of dealers and distributors all across the USA, high performers often spoke about the fact that shabby operators in the system damage the entire distribution network, eroding both the overall value of the brand and the equity value other operators have worked hard to build into their branded marketing businesses. Moving toward a "world class" franchising approach can, over time, have a very beneficial effect on qualitative aspects of fuels marketing as well, leading to improved customer perceptions and increased competitiveness in this era of increased customer expectation.

Designing a Sales Process

Franchise sales is the lifeblood of any franchise system. Oil companies typically have no existing sales expertise that is comparable to selling business opportunities, so this component of the franchise program usually needs to be crafted from the ground up. Investing in an effective selling system is at least as important as a great store design, a fact that is often poorly understood. Except in rare cases with proven brands that are in high demand, franchises don't sell themselves. Conversion offerings to existing dealers can sometimes be a particularly difficult sell if there is a legacy of ill-will within the systemÖunless the opportunity is very well packaged and very well sold.

A bright light for oil companies, however, is that a new convenience retail offering can be an excellent opportunity to bring new blood into the system in the form of outside-of-industry investor/operator candidates. For such candidates, the franchisee recruiting and sales process can be more like traditional business opportunity sales than the “conversion” of experienced dealers who may feel they “know better” than the oil company franchisor.

Most franchise systems in their early stages rely heavily on pioneering franchisees to support the sales process, singing the praises of the franchise offering in a way that the franchisor is constrained by law from doing. Of course, they must be having positive experiences for this to occur, another reason that the business system offered needs to work in the real world. The importance of making early franchises successful cannot be overstated; without successful early franchisees there will be no later franchiseesóword gets around fast in franchise circles, just as in fuel distribution networks.

Setting up an effective franchise sales function in an oil company requires special care, since the entrepreneurial environment is so different from traditional franchisor settings. Yet with the will to succeed, it can — and must — be done. A complication is that the laws governing information disclosure to prospective franchisees restrict the franchisor from making earnings claims, even though they may be true. In essence, it is like being a salesman with zippered lips; only pointing and armwaving allowed. Yet many conversion franchisors have successfully overcome this constraint and built powerful franchise systems. One key is designing the offering and the sales process simultaneously. Equally important is making absolutely certain that the pioneering “early adopter” franchisees are successful, top notch operators who are respected within the system.

The approach for selling an offering to jobbers/distributors, however, will necessarily be different from the approach for single investors, whether the latter are part of the existing system or new-to-industry outsiders. These approaches will be highly dependent on the business arrangement or form of alliance being proposed, and many different possibilities exist.

Third Wave Approaches Needed

Franchising, like any other successful field of endeavor, has tended to become formulaic over time. We have seen this manifested all too often in the way fee structures are approached. The truth is that there are no hard and fast rules for creating fee structures and other key aspects of the franchise relationship. While it may be tempting to borrow from other franchise companies, this can often be very dangerous. It can also be dangerous to look at franchising from a short-term perspective and try to “make it all up front,” or to fashion terms based on unrealistic short-term "hurdle rates" or similar guides to making investment decisions.

The fact is that starting a new franchised brand is starting a new business; it’s an investment in the future designed to fill certain gaps and/or take advantage of certain opportunities. A new business cannot become a national brand overnight, particularly one that is playing into an existing market with limited growth potential. From our experience, the only “right” way of structuring a franchise business relationship that can succeed in this challenging environment is to start with a fresh sheet of paper, an open mind and the goal of crafting win-win business relationships. Creative deal structuring and using non-traditional “third wave” franchising techniques can often be the difference between having a marketable conversion franchise offering and one that languishes, attracting few takers.

Because most oil company distribution systems rely heavily on the efforts of the jobber/distributor segment, no new c-store brand will achieve its potential without a major thrust into this segment. Yet for all its promise, this is where many would-be franchisors throw up their hands and say “they’ll never go for it.” To this we must invoke Gershwin: “it ain’t necessarily so.”

Innovative, non-traditional franchising techniques can create powerful opportunities where traditional techniques and mindsets have only created obstacles or failures. Jobber alliances can be fashioned in many different ways and there are strong incentives on both sides to make such alliances work. Co-franchising alliances are one approach.

We recently structured a co-franchising type of alliance whereby a major distributor handled most of the franchise administrative and support functions for the jobber segment — including franchise sales to distributor-served dealers and smaller jobbers — in exchange for a portion of franchise fees and royalties.The oil company was thus able to bring its offering to distributors very cost-effectively, minimizing internal head count while tapping the entrepreneurial energy and "street smarts" of a highly motivated, highly respected distributor. Stronger brand loyalty, more secure and predictable business relationships, rapid brand propagation and increased profits are some of the benefits of this particular form. It's a true win-win.

This kind of structure can work because even the best and strongest marketers don't really have the expertise, resources, marketing clout and time to build and support a major new c-store brand from scratch, as some are learning the hard way. While they are often excellent c-store operators and fuel marketers, building a new brand is the kind of undertaking that's relatively easy to start, but not so easy to pull off over time. Oil companies, however, have the resources, the reach and the staying power to develop all the necessary components of a new brand offering and take them to market. Crafting relationships that take full advantage of the strengths of both sides can create an awesome competitive force for c-store and fuels marketing. And such relationships offer a potential for brand propagation that cannot be achieved in any other way. Rapid brand propagation is one of the strengths of franchising, and innovative "third wave" distribution alliances may be the only way to tap the real potential of convenience retailing for oil companies who, arguably, have yet to produce a "best in class" c-store that is widely imitated.

There's More

Naturally, there's far more to say about "doing c-store conversion franchising right" than we have room for in this article. And, in any case, each real-world situation and set of challenges and opportunities will be different and demand a different mix of approaches.The bottom line, though, is that the franchising of convenience retail brands is both an important and achievable undertaking. Overlooking this powerful set of strategic business tools can be hazardous to potential profits from convenience retailing. • • •