

SLOW RECOVERY DIMS OUTLOOK FOR YEAR AHEAD

BY JOHN REYNOLDS, CFE



INTERNATIONAL FRANCHISE ASSOCIATION

Franchising

Building local businesses, one opportunity at a time.

The fourth annual Franchise Business Leader Survey, conducted in early December, reveals concerns among franchise business owners about the pace of the economic recovery, current business conditions, and the outlook for the coming year. In general, while more than half of those IFA members surveyed, both franchisors and franchisees, expect the U.S. economy to be “about the same” in 2012, there is a significant shift toward those who say the U.S. economy will be “worse” in 2012 than in 2011. Among franchisors, 10.3% believe the economy will be “worse”, compared to 3% one year ago. Only 31% believe the U.S. economy will be “better” in the year ahead, compared to 50% one year ago. Franchisees are even more pessimistic than one year ago – 22.2% believe the U.S. economy will be “worse” in the coming year, compared to 5.9% one year ago. Slightly more than 22% say the U.S. economy will be “better” in 2012, compared to 47.1% one year ago.

theme of frustration with the “lack of support for pro-growth small business policies,” and the “uncertainty created among consumers and investors” by the “negative rhetoric from both political parties.”

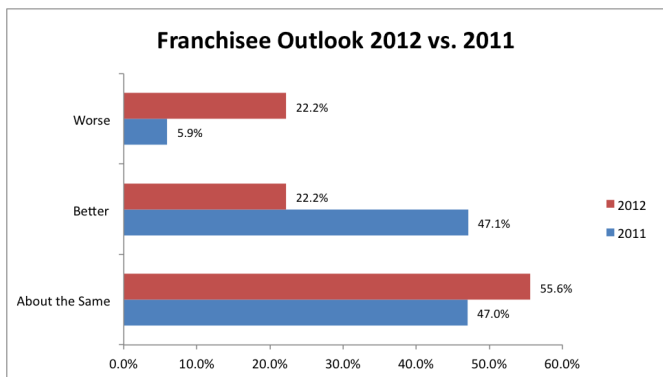
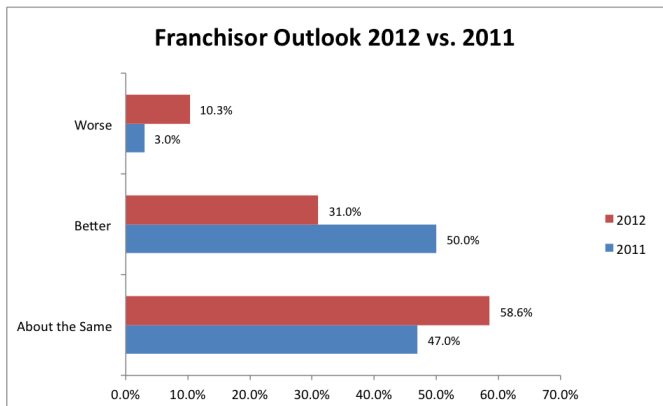
In general, with some variation in emphasis, the issues of greatest concern to franchisors and franchisees have not changed from one year ago.

The top issues for franchisors are –

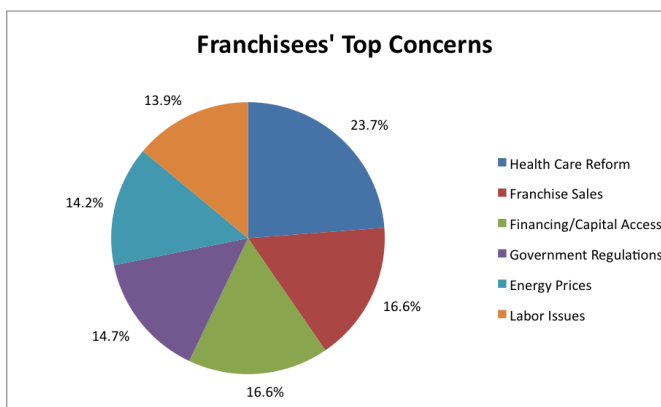
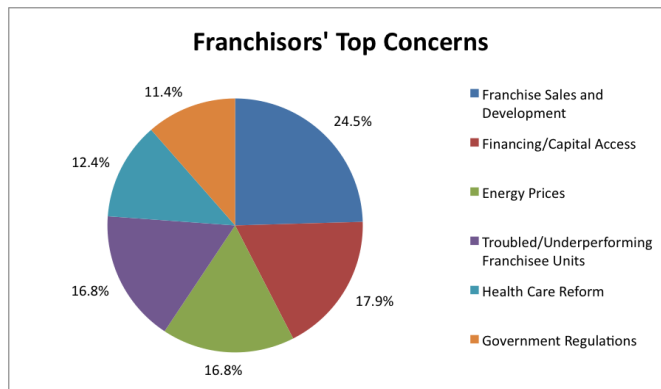
- 24.5% Franchise Sales and Development
- 17.9% Financing/Capital Access
- 16.8% Energy Prices (especially concern about commodity price increases)
- 16.8% Troubled/underperforming Franchisee Units
- 12.4% Health Care Reform
- 11.4% Government Regulations

Top issues for franchisees are –

- 23.7% Health Care Reform
- 16.6% Franchise Sales
- 16.6% Financing/Capital Access
- 14.7% Government Regulations
- 14.2% Energy Prices (especially concern about commodity price increases)
- 13.9% Labor Issues (Card Check)



According to comments from survey participants, the less optimistic outlook stems from franchise business owners who are frustrated with the pace of the economic recovery and the “lack of leadership in Washington, D.C.” that is “making things worse, not better”. Responses from both franchisors and franchisees revealed concerns about how a range of issues are impacting their bottom line – with weak franchise sales, limited credit access, energy price increases (especially commodities), and the impending health care law – all ranking highly. Survey comments revealed a general

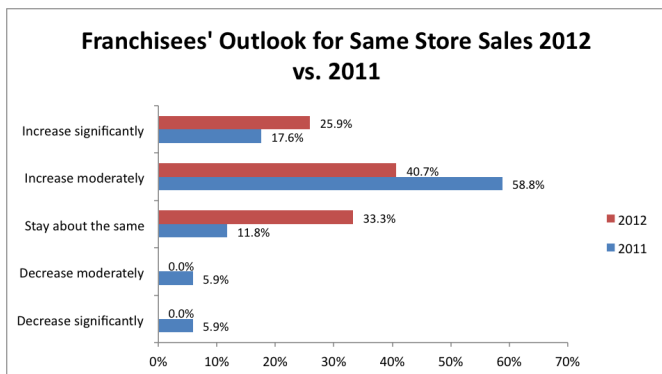
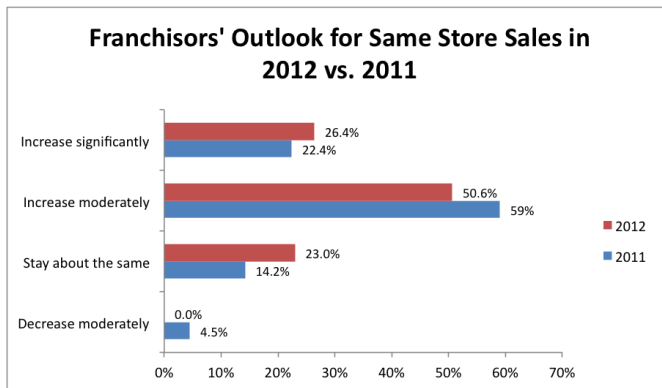


For the past four years, the Franchise Business Leader Survey has asked the same questions of franchisors and franchisees to spot any general trends in their current business conditions, outlook for the coming year, sales, and hiring plans.

Despite a somewhat pessimistic outlook for the U.S. economy overall, franchisors are more positive about the current “overall business conditions for their own business”. More than half (54%) say their business conditions are “Somewhat Good” (36.8%) to “Very Good” (17.2%). One year ago, half (50.7%) said their business conditions were “Somewhat Good” (14.9%) to “Very Good” (35.8%).

Franchisees are somewhat less positive than franchisors about current business conditions. Thirty-seven percent say their business conditions are “Somewhat Good” (18.5%) to “Very Good” (18.5%). Compared to one year ago, 41.2% of franchisees said their business conditions were “Somewhat Good” (35.3%) to “Very Good” (5.9%). However, 37% of franchisees say their business conditions are “Somewhat Poor”, compared to only 5.9% one year ago. In November, 2010, 17.6% of franchisees said their business conditions were “Very Poor”, while none reported business conditions as “Very Poor” in this year’s survey.

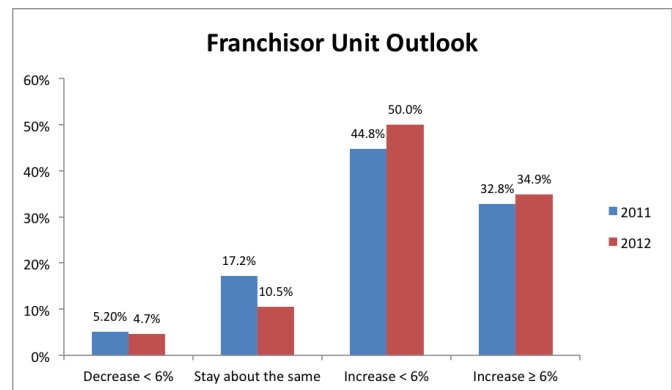
In terms of the outlook for same store sales in 2012, franchisors expect to see a sales improvement in the year ahead. Seventy-seven percent of franchisors expect some increase in same store sales, compared to 81.4% of franchisors one year ago. Of those, 26.4% expect same store sales to increase by 6% or more, compared to 22.4% who expected sales of 6% or more in last year’s survey. No franchisors say they expect a same store sales decrease in the coming year, compared to 4.5% who expected same store sales to decrease in the 2010 survey.



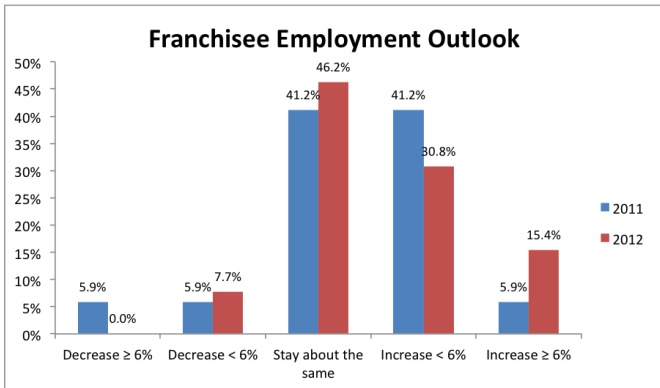
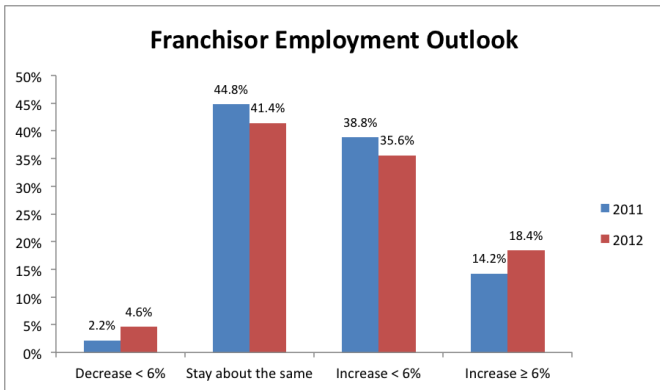
Those franchisors with international operations are more positive about the outlook for same store sales in their overseas locations. Eighty-four percent say they expect to see some sales increase from moderate (less than 6%) to significant (more than 6%). One year ago, 77.5% of franchisors with international operations said they expected to see moderate to significant increases in same store sales.

In general, franchisees are less optimistic than franchisors about the prospects for improved same store sales in the year ahead. Two-thirds (66.6%) of franchisees say they expect to see moderate (less than 6%) to significant (more than 6%) increases in same store sales in 2012. This is a less positive outlook than one year ago, when 76.4% of franchisees expected to see some increase in same store sales, from moderate to significant. On a more positive note, no franchisees say they expect to see a decrease in same store sales in 2012, compared to nearly 12% who said one year ago that they expected a sales decrease.

Franchisors are very optimistic about plans for expansion in 2012. Nearly 85% say they plan to increase units, with more than one-third (34.9%) saying they plan to increase units by 6% or more and half saying they expect a moderate increase in the number of units (less than 6%). No franchisors expect a significant decrease in the number of units and 4.7% expect a moderate decrease (less than 6%).



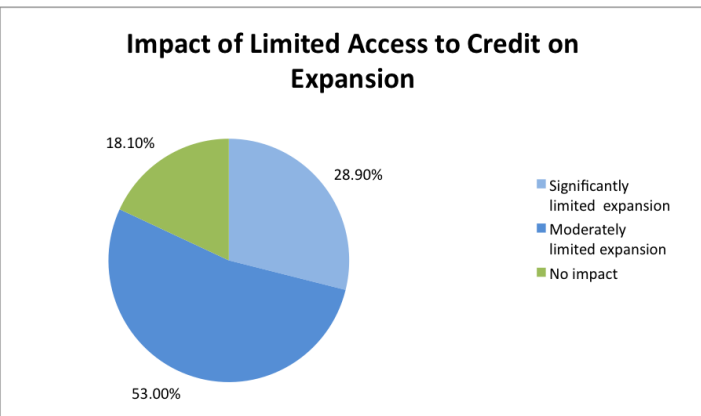
Similar to the survey one year ago, about half of franchisors and franchisees plan to add jobs in their businesses in the year ahead. Fifty-four percent of franchisors say they expect to increase employment, with 18.4% saying they expect a significant increase (6% or more). One year ago, 53% of franchisors said they expected to increase employment, with 14.2% saying they expected a significant increase. A small number (4.6%) expect some moderate decrease in employment. Also similar to last year’s survey, nearly half (46.2%) of franchisees say they expect to add jobs in the year ahead, with 15.4% saying they expect a significant increase in the number of jobs (6% or more). One year ago, nearly half (47.1%) said they expected to increase the number of jobs, with 5.9% saying they expected a significant increase.



CREDIT ACCESS, HEALTH CARE, AND TAX REFORM

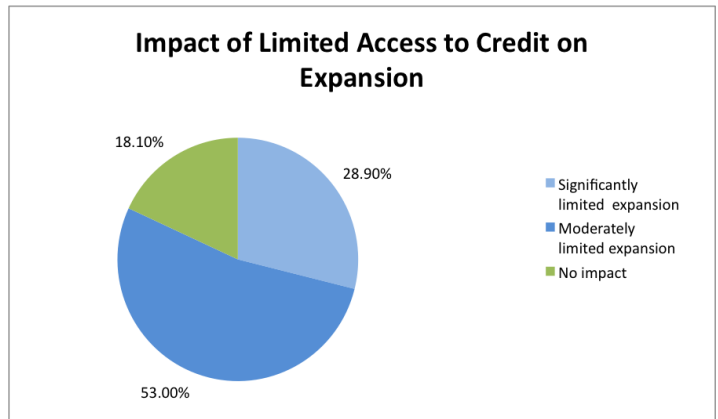
Throughout the year IFA has surveyed its members on a wide range of issues, with a special focus on financing/credit access, health care, and the tax reform debate. Following are some highlights from the most recent survey with comparisons to earlier survey results.

Two-thirds of franchisors (66.3%) say they have seen “no improvement in credit access in recent months”, compared to nearly the same result in an August survey (67.6%), and the survey in November, 2010 (65.2%). According to franchisors, limited access to credit continues to hamper the ability of franchisees to get financing. More than one-fifth of franchisors (21.7%) report that half or more of their franchisees are unable to get financing. Nearly 16% of franchisors say that one quarter to one half of their franchisees are unable to obtain needed financing. More than 80% of these franchisors say that limited access to credit continues to have a negative impact on their ability to expand, with 28.9% saying it has a “significant impact” and 53% saying it has a “moderate impact”.



In similar findings, 44.4% of franchisees report “no improvement in access to credit” in recent months, compared to 75% of franchisees one year ago. More than one quarter (25.9%) of franchisees say they have seen “moderate improvement in access to credit”, compared to only 6.3% one year ago. More than half (55.5%) of franchisees say that limited access to credit continues to have a negative impact on their business, compared to 62.6% one year ago. These survey results indicate some slight improvement in access to credit among franchisees compared to the same time period last year.

In August of this year, IFA commissioned the Hudson Institute to conduct a study on the impact of the healthcare law on franchise businesses. (See report, *The Effects of the Patient Protection and Affordable Care Act on the Franchise Industry*, (http://www.franchise.org/main_healthcare.aspx). As one element of the study, IFA also surveyed its members to gauge their views about the healthcare law. Franchisee members rank healthcare as their number one concern and 85.8% have negative to very negative (67.9%) views about the healthcare law. Only 10.7% of franchisees view the healthcare law positively, with 3.6% very positive. More than three-quarters (77.7%) of franchisees say the healthcare law will “increase the cost of my business”, with 48.1% who expect a “significant increase”. Two-thirds (66.6%) of franchisees say the impending healthcare law has complicated their business planning by “creating uncertainty”.



More than 80 percent of franchisors also view the healthcare law negatively, with 43.4% saying “very negatively”. Only a small percentage, 3.8% view the health care law positively. Others stated they were neutral or “did not know”. Similar to franchisees, 77.1% of franchisors believe the healthcare law will add costs to their business. More than half (57.9%) say the healthcare law has complicated their business planning by “creating uncertainty”. The annual survey asked IFA members their views on tax reform issues being debated in Congress.

In one question, the survey noted if current tax rates are allowed to expire, income tax rates on households earning above \$250,000 would increase by 3.5% on December 31, 2012. More than 81% of franchisees are opposed to allowing tax rates to expire, with 70.4% saying they are “strongly opposed”. Many franchisees are organized as pass through entities (such as S-Corps) and are, therefore, more likely to be impacted by the increase in tax rates on household incomes above \$250,000. More than two-thirds (68.7%) of franchisors are opposed to allowing the tax rates to expire, while 16.9% are neutral and 14.4% support such a measure.

The survey asked IFA members their views about trading some business deductions for a lower corporate tax rate (below 25%). More than 59% of franchisors support this tax reform proposal, 30.1% are neutral, and 10.8% are opposed to it. More than 44% of franchisees support this proposal, while 48.1% are neutral, and 7.4% are opposed to it.

BUSINESS CHARACTERISTICS OF SURVEY GROUPS

The survey was distributed via email to 1,459 IFA members, including notices in IFA publications such as the IFA Insider and SmartBriefs, with 149 members responding to the survey, for a response rate of 10.2%. New for the annual survey, IFA gathered additional information about business characteristics of franchisor and franchisee members.

For franchisors completing the survey, in terms of size, one quarter (25.8%) had less than 50 units, 28.1% had 50-199 units, 15.7% had 200-499 units, and 30.3% had 500+ units. These franchisors ranged in size based on their number of corporate employees, with more than half (53.4%) having 1-50 employees, 17% with 51-100 employees, 9.1% with 101-200 employees, and 20.5% with 200 or more employees. Nearly two-thirds of these franchisors (64.8%) had been in franchising for 11-plus years, with 13.6% from 6-10 years, and 21.6% with less than 5 years experience in franchising. In terms of estimated gross system-wide sales, more than one-third (34.9%) had sales over \$100 million, with 14.5% from \$50-100 million, 12% from \$20-\$50 million, 10.8% from \$10-\$20 million, 10.8% from \$2- \$10 million, 12% under \$2 million, and 4.8% reporting no system-wide sales.

For franchisees completing the survey, in terms of size, nearly one quarter (22.2%) had 26 or more units, 18.5% had 11-25 units, 11.1% had 6-10 units, 29.6% had 2-5 units, and 18.5% had 1 unit. By employee counts, more than one-third (34.6%) had 50 or more full-time employees, 19.2% had 21-50 employees, 7.7% had 11-20 employees, 19.2% had 6-10 employees, and 19.2% had 1-5 employees. Franchisees also reported on the number of part-time employees, with more than one-third (37%) with 50-plus parttime employees, 14.8% with 21-50 parttime employees, 3.7% with 11-20 parttime employees, 7.4% with 6-10 parttime employees, and 37% with 1-5 parttime employees. In terms of gross sales/revenue from their business, two-thirds of franchisees (66.7%) had sales of \$2 million or more, 11.1% had sales of \$1 million - \$2 million, 7.4% had sales of \$500,000 to \$1 million, 14.8% had sales of \$250,000 to \$500,000. None had sales under \$250,000.