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Recorded Message: Welcome to the REI Diamonds Show with Dan Breslin, your source for real estate investment, Jewels of Wisdom.

Dan Breslin: Welcome to The REI Diamond Show. I'm your host, Dan Breslin. And this is Episode 197 on how to invest in a franchise business with Jon Ostenson. If you're into building wealth through real estate investing, you are in the right place. My goal is to identify high-caliber real estate investors and other industry service providers, invite them on the show, and then draw all out Jewels of Wisdom, those tactics mindsets, and methods used to create millions of dollars or more in the business of the real estate.

So today's guest, Jon, is a consultant, investor, author, and international speaker specializing in the area of non-food franchising. Having served as the President of an Inc. 500 franchise system, and now as a multi-brand franchisee himself, Jon is uniquely positioned to educate others on franchising and franchise selection. In addition to serving as the CEO of FranBridge Consulting Jon oversees Franbridge Capital where he and his partners actually own and operate multiple service franchises.

So today's episode is a little bit of a different avenue than we normally go. But it ties in because real estate investors like me and you, rely on the next deal in order to remain profitable. I'm always hunting for the next deal. I'm sure you know the feeling. And with the tightening of the real estate market over the past two years and deals becoming harder to find, some real estate investors are turning to franchise business ownership. Jon and I discussed an opportunity to get consistent cash flow by investing in these non-food franchise businesses.

We also discussed Jon's building of a portfolio of franchise businesses. The reasons why exiting, meaning, selling a franchise business is often more profitable and much easier than exiting a business that you've constructed yourself and why you should run from food franchise business models. Normally, what most people think of when you hear the word franchise. Please enjoy this conversation with Jon Ostenson.

All right. Welcome to the REI Diamond Show, Jon. How are you doing today?

Jon Ostenson: I'm doing great. I appreciate you having me on.

Dan: Yes, for sure. So for listeners, we're going to go in a little bit of a different direction than our usual buy apartment buildings, flip houses-kind-of-a topic which is exciting. I was looking forward to this show when our booking agents got together and arrange this on our schedule. So do you want to give the origination story, the background, and what your business model is, Jon?

Jon: Yes, absolutely. So my background, first off, is I spent most of my career in the corporate world. And like so many others, had that desire to do something a little more entrepreneurial. And about five years ago, I stepped into a smaller private company called ShelfGenie. It's a national franchise system. And had the opportunity to serve as President, leading the home office of marketing teams, call center technology, all supporting franchise owners of our brand around the country and around Canada as well. We have about 180 locations and [inaudible] business. And that experience really opened up my eyes to the world of franchising outside of food. Oftentimes, when people think franchising, they think food. But there's a whole another world that exists out there. And long story short, I ended up partnering with the founder of ShelfGenie and we are now franchisees.

On the other side of the table are sales. And we have a pool cleaning business, home cleaning business, and a carpet cleaning business and we're looking to expand that portfolio over time. For the most part, we have good people that run those businesses for us, so I'm able to spend about 90% of my time consulting with clients, helping them find the right opportunities for investment or, in some cases, to jump in and leave their day job and become full-time owner-operators. But a lot of the clients that I work with are real estate investors. I'd say, in fact, probably the majority and there are certain sectors, oftentimes attract them within franchising whether it be home services or property services or they're looking for more of a real estate play that has a business component to it.

And so, I just love having the opportunity to walk them through the process, expose them to opportunities, help them understand the ins and outs of business ownership through franchising and what we found is, for many of them, franchising really is a great complement to what they're doing on the real estate side.

Dan: Yes. And let's talk about that. I mean, why are they so interested? Real estate investors were looking for a rate of return, passive income, that kind of thing. And my first thought is I feel like I could be totally wrong, but I feel like when I go to Subway, sometimes it's the owner who's in there making the sandwich. And to me, as a real estate investor, I'm like, "Man, I don't want any part of a franchise that I'm going to basically have a high-paying job." Right? We're looking for rental properties that are managed by the third-party management company that spits off cash. Maybe not enough as if I were actually in there doing all the work myself, but great a way to put my savings to work, right, Jon?

Jon: Right.

Dan: Why is the real estate investor community the buyer right now that you seem to be doing a lot of business with?

Jon: Yeah, a couple of thoughts there. So first off, you know, Subway, which is part of the food category. I do stay away from food. That is much more of an owner-operator type [inaudible] businesses we work with and we'll delve into the [inaudible] in a minute. Offer the owner-operator opportunity but they also offer what we call a semi-absentee. Now, it's not entirely absentee. It's typically semi-absentee, but that could be as few as 10 to 15 hours of work a week. Really, if you're able to find the right general manager to help run the business. So, I find that most of my clients, especially those with a day job, those that are doing real estate investing, are tight on time and a lot of them are looking for those opportunities that they can do on the side, essentially, a side hustle.

On the economic side, when I give talks to investors, I find that the light bulb oftentimes goes off on what it means to buy into a business. As your listeners know, owning a business, you are able to write off certain expenses that you couldn't. If you just had a corporate job, so that's one piece of it. But beyond just the cash flow, you're in. You're out. You're also building an asset, just like you are in real estate that's going to have a residual exit value down the road. There should be a multiple of what you paid for it in the beginning. So you're not just buying a job, you're building an asset.

And when we look at the margins out there, oftentimes, these opportunities are carrying EBITDA operating margins of North of 20%. Not all of them, but you certainly have a quite few. They're North of 20%, and that is on revenue. Now, when you look at what your initial investment is and you extract, do the math behind that return on your initial investment, you're talking significant percentages which, definitely, I'd say in some cases, rivaled the returns you get on real estate. So, it's a great way to diversify the portfolio. With my clients, they recognized that, right now, the stock market is at an all-time high. It was actually at a new record this morning. Interest rates are low. It's a great time to be in real estate and diversify some of your money there. But there are also only so many good real estate deals we have at times and some people were saying, "Hey, how do we complement and maybe create a new asset class within our portfolio?" and that's why they're turning to franchising.

Dan: Yeah, and I think personally, where I'm at and why I was also so excited about this is we do a volume of deals. I think we're at 185 close for the year or something like that and we have a large team and a good opportunity going. And then, I look at some of the rental properties I bought and they've gone up in value but the cash flow that they're actually spitting off is, I kind of alluded to at the beginning of our episode here, it's not moving the needle the same way.

I have kind of a mastermind [inaudible] with some MMA guys and their thing is buying businesses, selling businesses, somewhere in the one to five or even ten million dollar range. And they're talking about 20% return on that million-dollar purchase price, maybe even 25% return on that purchase price and it's like you're going to put $100,000 to $200,000 down on that million-dollar business, but if it were able to run and throw off that 20%, we're talking what? Like $200,000 a year [laughter] positive? Even with the debt service, I don't know whatever it is, $8000, $9000, it's still talking about probably $100,000 plus in free cash flow at the end of the day. So I guess what I'm saying in a long roundabout way is there seems to be some higher ROI, maybe not quite as absentee as real estate opportunities for people who start off in our business flipping houses, holding rental property, doing some refinance for cash, but then getting into some things that are, you know, we're doing one deal.

Let's say, I'm not saying to deal is mine, but that million-dollar example, where that one deal we put together, throws off $8000, $9000, $10,000 a month. That's really moving the needle versus a million-dollar apartment building that I might buy, where I put the same amount of money down. I have a little bit of more hands-off experience there, but I'm probably lucky to get $25,000, $35,000 at the end of the year after all the expenses and it's doing its work for a lot of other reasons. It still makes sense to buy that deal but it's certainly not going to be the needle moving kind of a thing where a business is, perhaps. So let's talk buying into existing businesses or I guess, we could take it down the avenue which is probably you're more familiar with, Jon. But what are the pros and cons of buying into a business in the form of a franchise versus starting a company from scratch?

Jon: Yeah. First of all, say, franchising is not for everyone. It's definitely an avenue for many but it's not for everyone. I have some clients that I have to explain. You're too entrepreneurial. You want to put your thumbprints all over this entity and maybe go outside the lines and most franchise works[?] will allow you to inject your personality into the business but it's tough to stay within the guardrails. But I find that so many of my clients do say, "Hey, I love the idea of not having to reinvent the wheel. I loved that with the franchise, I essentially get a coach on the sidelines, that franchisor who's cheering me on and who's coaching me has that aligned interest. I love that there's a playbook." This has been proven out in other markets. It's great to have other franchisees, kind of colleagues around the country, that again, are aligned with my interest. The better I do, the better I represent the brand, the more their locations are worth.

And then, finally, from an exit standpoint, the Rinker School of Business recently came out of a study. They looked over 2,000 companies over the past 10 years and looked at their exits in comparable industries across a wide range of industries, they looked at the franchise to and non-franchised. And what they found is those franchise businesses traded at a multiple of one and a half times than non-franchise which, I knew it was higher, [inaudible] if that is a sure thing even with a proven model. You're still going in. You're incurring some level of risk as you are with any venture. However, getting to go in and review Item 19 of the FDD which is the disclosure of how every other franchisee is performing within the franchise system, that's definitely a helpful data point.

I've been going through what's called validation and talk to other franchisees about their experience and their ramp-up. It gives you some really good data points going in. But again, it's not a sure thing. It comes down to your ability to attract talent, to retain and incentivize that talent, and to make tough calls when needed. I think that's the key piece that people are bringing to the table as well as referral partners and local market expertise. So, I do think when you're buying into an existing business, a lot of times people say, "Hey, you could go with the startup route which is even it's pretty risky." Just numbers would say or you could buy an existing business. The entrepreneurial through acquisition is a really popular theme right now. The downside, there would be you are paying multiple typically to get into the business. Positives would be there, may already be some cash flow. There may be brand awareness. There may be a team in place. Assuming all these things are good things, they could be bad at the same time.

Dan: [laughter]

Jon: So there's not necessarily a right or wrong. There are just different flavors here of business ownership. I will say, with a lot of my clients recently, there were looking at existing businesses and got excited about them. They have now come around to franchising because they said, "Hey, once I pull back the covers, I realized the books really weren't what they were portrayed to be." Yeah. I think that's a big challenge. A lot of times when buying into an existing business is really understanding if the books were well kept and what is hidden under the covers.

Dan: Yeah, it makes sense. And as you talk it through, I think of my own Diamond Equity Investments, our company. And we have our Atlanta location, our Chicago location, our

Philadelphia location. And these are kind of set up. Although, we're not like franchises. There's like, a specific partner of mine who's in each of those three businesses, who is operating individually of the other with me being at the center stage of this whole thing if you will. And some of these very valuable yet maybe intangible benefits that, as you're talking about franchising, would probably exist more in the franchise world, would be the brand recognition.

So we're in these three markets where there's a larger company. So we have that where one market is boosting the brand, so is that helping the other Google reviews, testimonial videos, whatever the case is. But then, we also have that same thing, this camaraderie. So a lot of businesses, business owners, who are like, "Oh, one location, one area kind of a thing." It can be very hard. Who are you going to network with, talk to? If your interest on the line, you're not going to go to the trade association that's in that location, share all the best things with your competitors. So there becomes this leveraging of common collective wisdom that occurs for our company and that's probably one of the biggest things that we have.

So, the culture that we have is fun to be a part of for people on my team. We were about growth. We're setting goals. We're boosting each other up. We're high-fiving. We're catching one guy when one guy is going through a slump very quickly as opposed to the guy who's operating all in a vacuum trying to do all that himself. I don't know. It's more fun when there's a little crowd of people there. And then, we haven't really talk exit plans and things of that nature. But if I'm in the franchise model, if I looked at my own, perhaps that's the same way, the ideal buyer maybe, at some future point, is going to be someone who already kind of knows the business model, maybe one of those other franchise location owners because they're experienced in the business.

They understand the books. They understand the business model. They're aware of the brand. They've already bought into the value. And so, maybe the future is being able to exit from this proven system and sell your share or piece of the brand which leads me to the next layer. You had mentioned that you're putting together this portfolio, Jon. So there are probably some people who would call you up when we've done our podcast. "Jon, yeah. I like it. I want to get into the pool cleaning or this or that." And then, there are probably some people who are all about scaling the business and you mentioned portfolio and their ears are perked up and are thinking. Okay, so I get into one and now by 20.

And I've heard rumors of people who have young brands, for example, a large collection of a large number of restaurants in franchises. And I would assume they're buying different franchisees out as they're retiring and moving on and things of that nature. Can you paint the vision for what a portfolio of franchisee or franchises might look like for someone who's looking for not just the first step? But what does this look like and the real magnitude in size and scale of the opportunity, if we're looking at this more like a portfolio type of FirstStep investment if that makes sense?

Jon: Yeah. No, absolutely. And that's a great question and a lot of people are thinking that way. Right now, around the country, I've got many clients that are starting to build that portfolio. And I think a great example would be a client of mine, Nathan, over in South Carolina that he became the largest franchisee of Two Men and a Truck. So he got in, started his own location, started buying other locations. He operates and I believe 12 markets now, throughout the southeast. And then, so he's built up a team, a strong operational team.

And so, in his case, whereas in Atlanta, what we're doing with our portfolios, we're building a portfolio of complementary brands where we get the economies of scale of shared services on the back end and we get the referrals and cross-selling on the front end. He's going at it a little different route saying, "Hey, let's create a diversified portfolio franchise brand. So last year, he and I did a deal for a business. It's a truck with a big old, crane arm on the back and it goes up to roll-off dumpsters and rolls back and forth, smash down the debris in the dumpster to about one-quarter of the original size. Thus, saving three out of four trips to the landfill for that user. There are some innovative concepts like that one. So he bought into that one, three territories has since come back and bought a fourth.

Last year, he and I did a deal on a driveway repair business that has a lot of great uniques about it. I'm personally invested in myself on the side. [tongue clicking] So anyway, he bought into that. He's had great success over the past six months. He's now come back and said, "Hey, I want to buy the whole state of South Carolina, what will that take?"

Dan: [laughter]

Jon: So, yeah, I love success stories like that and that's definitely the case for most of my clients. But no, I'd say those are two different approaches. One is the diversified strategy. One is more of the complementary strategy. And sometimes, I'm going to deal with a client right now where he is buying into his first franchise brand, but he already has several businesses that he started outside of franchising. [tongue clicking] But as I mentioned, the majority of my clients are real estate investors because they understand, "Hey, I want to be outside, just the markets from our returns." And what they see is just an opportunity to go out there and do things better in some of these spaces like property management. Could be everything from a property management company to the SIR prototype model of the world. It could be a roofing business, a kitchen remodeling business, pool cleaning business.

I've done a couple of mosquito deals in the last couple of months with real estate investors. A lot of times they already have those multi-family relationships or they have a portfolio of single-family homes. And even if they don't, if that's where their interest lies, it just complements it so well, so very, very relevant. I got on the BiggerPockets podcast. I think we've done six deals with some of their listeners just in the past four or five months since I've been on that show. So, yeah, lots of interest from the real estate community in franchising is what I'm seeing.

Dan: Yeah, real estate investors have a little bit of cash to play with, I imagine. What is the financing structure? Where do you start? You don't have to share all of these particulars, but how are these next steps happenings at all from cash flows? You bring in investors on each step of the way because I think listeners are going to want to construct in their mind how they're going to take down something like this.

Jon: [tongue clicking] Yeah, absolutely. So first off, let me just [inaudible] I think about franchise businesses as[?] four quadrants. You've got simple retail, complex retail, B2C services, and B2B Services. I want to get too granular on the categories within those now. But to get at your question, if you're doing a brick-and-mortar location or retail type build-out, your costs are going to be higher than if you're doing a service-based business that doesn't require a physical location, at least not a customer-facing one.

So I'd say the range all-in franchise fee, build-out cost, initial marketing cost, initial working capital, it's what we call the item seven of the FDD and it's given us a range by the franchisor. You're doing a retail-type space. You're probably somewhere between a hundred fifty, probably $200,000 up to let's call it $600,000 or $700,000 with quite a few deals happening in the $300,000 range. If you're doing more of service-based businesses like some of the property services, ones I just described, you could be in for one location as low as $100,000. I'd say the majority of the deals I do, people buy three territories or three locations. Typically, in that $200,000 to $250,000 range is kind of the sweet pot that I'm seeing from an all-in investment standpoint.

The way people go about making that investment, one obviously cash or friends and family. That's always nice but people are leveraging SBA loans quite often, either the SBA Express Loan, typically a $150,000 and below, or the SBA 7(a) Loan. In addition for those to have built up some retirement assets, they use what's called a ROBS Program. And we work with some great providers that really help clients through this process. With the ROBS Program, you're essentially leveraging your 401k or traditional IRA to fund the business. You have to set up as a C-Corp. You have to jump through a few hurdles, but that is a very common way to fund the business and without any tax implications, if you structure this certain way.

And then, lastly, I'd say--

Dan: So is that one there, Jon? The IRA one. That's kind of interesting. I know a lot of people are going to resonate with that.

Jon: Yeah.

Dan: So treat it like a rollover? Is that like taking a loan from the IRA? Would you mind just going in slightly granular there?

Jon: Yeah, it's a little more of a rollover type setup where you don't have to pay the penalty for an early withdrawal instead of investing less say, in stock, you're now invested in the business. And so, it does require another level of reporting and kind of upkeep. You have to establish yourself as a C-Corp. FranFund is an organization that most of my clients work with when they do that program and they take you through the ins and outs, but then they also stay on top of that ongoing maintenance and you pay them I think it's a monthly fee. They orchestrate that. So that's common.

One other thing that might be of interest is a non-retirement brokerage account loan. And so, I've got a great partner up in Charlotte, North Carolina that will do what's called a portfolio loan where, essentially, your assets are your security [inaudible] which the ROBS or having to liquidate positions. With a portfolio loan, you can keep those positions in place and you're just borrowing against those up to 70 percent of their value. So let's say you had $200,000 in a brokerage account. You can borrow up to a $140,000 functioning as a credit line. So it's not that you have to take it as one lump sum, but you can take it as you need it.

And right now, based on where LIBOR is, you can get as low as 2% to 4% which is free money.

Dan: [laughter] Got you. Does the IRA own the business? I mean, if you do the exit 10 years out, it goes back into your IRAs, that kind?

Jon: Yeah, great question. Dan, I don't want to speak out of turn on that as far as what exit looks like. I'm not a hundred percent sure if FranFund could definitely guide you through that. My understanding is yes, the IRA does own it. How that gets treated at the time of the exit? I believe, again, you're not getting penalized for the retirement. You're probably paying tax on it, but you're not taking any tax penalty, some sort of the early withdrawal that you previously took. So you're able to leverage those funds just in a different way, but I don't want to speak out of turn and around the exit piece on that.

Dan: Yeah, it's pretty interesting. So let's go with a real example. Something that, if someone is listening right now, they could pick up the phone and when we're done, the episode, "Jon, I want in on that one." Cost to get in, size of the opportunity, scope. Let's go through the exact details as if I were a client of yours looking for a business right now.

Jon: Absolutely. Gosh, that's fun. Which one should I go with?

Dan: The best one, I hope. [laughter]

Jon: Best one. Okay. How about this? Sweet? Yeah, I get excited when I start talking about these specific opportunities just to deal a placement with a client. There's a couple up in New Jersey, in Marlboro, New Jersey. And they were a previous business owner, owned a printing company. And they had heard me I think is on the Entrepreneurs on Fire podcast or something similar. And sought me out and said, "Hey, we're interested in business ownership, one is for franchising. And so, I took them through a process where I got to know them, had a couple of calls, asked them a lot of questions to help fill in some of the blanks of their understanding of franchising.

And then, ultimately, I did some research on the backend working with the franchisors. I represent about 300 franchise systems and narrowed down the opportunities that are available in their area that match their criteria. And we walked through probably six or seven opportunities. Looked at the websites. I gave them all the color on the backend of the business, a lot of anecdotal feedback based on my relationships with these franchisors. And then, we narrowed it down to three opportunities for them to take the next step with where I made the introduction on their behalf to the franchise systems. They then had three.

I believe they had what's called the unit economics call. They did a territory review. They did that D review. They went through the franchisor's process and, ultimately, they said, "Hey, this is the one that..." and I think they dropped one or two and then we added in one or two more that for consideration. They ultimately went with a brand. It's a SIR prototype business. Water mitigation, mold remediation, 17-billion dollar industry. It's really a B2B play because you're working with landlords and property managers and insurance brokers. Those are who you're calling on but they got really excited about the business, about the growth. This business just hit a hundred territories nationally. It's been on a nice growth trajectory in recent months.

Say way, it all checked out. They spent time down South Florida where the franchisor is based at what's called a discovery day, formed that relationship, got to know each other, said this is the right fit. Meanwhile, I'd had them working with the franchise attorney to do a review of the FDD on their behalf. They also had applied through the SBA through FranFund for an SBA loan. They didn't SBA Express Loan. So they did that in conjunction as they're going through the process. They then paid the franchise fee of $49,000 for the one territory out-of-pocket, and their waiting on the SBA loan now to come back. They got pre-approved but the funding always takes a little while to hit, so the funding will hit their account, reimburse them, pay for additional cost of starting the business.

All-in investment on this business, you're in the ballpark of 120 to 150. If you do one territory, territory is being defined by population or a number of addressable households or addressable businesses. Everyone defines it a little bit differently, but they plan to buy additional territories over time. And then, as far as item 19 goes of what the financial representation is, it's based on the corporate location down in Naples, Florida. They have been in business for seven years. The item 19 is $4.1 million top-line revenue annually, with a $1.3 million drawn from the bottom line. I always tell my clients, "Hey, when we see those types of returns, and it's based on the corporate location, let's go very conservative in our analysis as we build out a pro format." But obviously, in a case like this, even if they do one-third as well as a corporate location, there's still a lot of meat on the bone. It's an attractive investment.

Through the process, they were getting to talk to other franchisees, hear about their experience, their ramp-up period. It really help inform their decision-making as they went through it. So anyway, the business was founded by great guy. He'd built up another company HPAC and plumbing business to eventually had an exit to a Fortune 100 company. Took all that experience into this one. Saw an opportunity. It's a 17-billion dollar market, a lot of share to go around. And so, that's an example once been on a great run and how I took the [inaudible].

Dan: So $4.1 million. Did you say the corporate ended up with like, what was the profit for corporate on that example?

Jon: Yeah, $1.3 million.

Dan: Okay, so $1.3 million in the end, which is, I don't know, 20%, 30% almost on that one?

Jon: Give or take, 30%. Yeah.

Dan: Okay. And what type of active owner is going to be required here? I mean, you're spending a $120,000 or $150,000 on what exactly and then what role will these owners play during the ramp-up period time commitment until they get that thing on its feet?

Jon: Yeah, in their case, they are going to run it owner-operator. Seville go full-time. I'm managing the team. They won't be out there doing the work, but they'll be overseeing. The team will be out there and the Chamber of Commerce and the business community, building those networking partners with landlord's property managers, insurance companies. I do have another client that's in the process right now for that same brand that we'll be managing it as a semi-absentee. And so, what he has done is he's found a general manager that will be essentially acting as the owner[?] and then he will have touch bases with the general manager throughout the week.

Dan: What kind of a salary does he pay the general manager? Do you know?

Jon: Yeah, I believe it was $60,000 and then a pretty healthy incentive program around profitability. So aligning their interest both on the top line as well as on the bottom line, the expenses. The guy's able to run a job, two people instead of three people. You want them thinking like an owner. So I believe there's a quarterly profit-sharing program with the goal of getting them into six figures, probably a little north of a hundred.

Dan: Yeah, I know people are going to be thinking about that. How do I scale this, leverage it out? You find an old Servpro guy with all the contacts already, like a plug and play, but you probably gotta give him a little more incentive to come on over to your thing.

Jon: Yeah, and most positions out there, for something like that, you don't have to have a background in it. The franchisor helps in that training process. And so, if you want to send your key personnel to the franchise org, they can go through a week of training, usually at no cost. And one thing I would mention, too, is I take clients through the process. There's absolutely no cost to the client. I get paid by the franchisor on the backend and none of that gets passed on to my clients. The franchise fee is a franchise fee. So it's strictly a sales and marketing expense for the franchisor. None of that gets passed on to my clients.

Dan: What kind of a down payment was needed for this? Example, we went through on the SBA loan, and is it unusual right now? Because we're still in the middle of the Covid subsidies or is that pretty much going to be the going thing? No matter if someone calls now, six months or a year from now.

Jon: Yeah, I know. I mean right now the government is very eager to create jobs, to start new businesses. And so, they have been very generous in their SBA policies. However, yeah, we were doing a lot of SBA loans prior to Covid as well so I expect that to continue. But, typically, you're in the 20% to 30% range from a downpayment standpoint just depending on your background and financial situation. So in their case, I think the loan was for $150,000. And so, it would have been what's called 25% of that. You're in the ballpark right there of probably around $40,000 or so. They did pay for the franchise fee out-of-pocket to secure that territory because territories were going fast for that brand.

Dan: [laughter]

Jon: They pay that and then the SBA will reimburse them but they've been pre-approved so there's nothing to be concerned with on the funding side.

Dan: Got you. Let's talk absentee or minimal owner activity. What would be the one, two or three segments or business model perhaps? Maybe we sort of covered it with hiring the GM but, if that were something high on my list, which franchises or segments would I want to consider?

Jon: Yeah, it varies. [laughter] It varies. That's an answer. I've got a client right now. Here's another real-world example that he's in the process of buying nine locations in Atlanta and Charlotte of an oil change business. This oil change business is entirely, to my absentee, typically staffed by two people at a location. What they do is they go about it a little bit differently. They use unused parking spaces in retail shopping centers. So you increase the additional revenue stream for the landlord. You've got great traffic visibility, built-in traffic as well. Typically, eight unused parking spaces for a one-bay location. It's a prefabricated building backed by an investor group. And so, you're literally leasing the building from them.

They're handling the sewage hook-up, the pit dig-out and everything. But my client, he's not going to be involved in the business. He is putting a manager over at each of the three locations and I may enter the work in the business in one of the locations while overseeing an additional two locations. And then, I don't know the exact pay scale that he's paying them, but it's definitely a line to a profit-sharing type program. [tongue clicking] And so, yeah, it's something that he's really excited about but he owns a property management company. He owns a flooring company that both do very well. And he said, "Hey, yeah, I've got some excess cash. I'd like to diversify my portfolio. Fell in love with this opportunities." That's a real-world example, but as far as outside of that, I'd say health and wellness, fitness space. Obviously, it can be crowded at times but their categories within that maybe they cater to the senior population where you're not having to be in their day-in-day-out.

So a lot of these property services businesses also cater to that. There's a great gutter business right now. There's a great insulation business, both of which can be run semi-absentee, but you have to have the right general manager in place. And so, I think that the key is, will someone be able to find that general manager, someone that they trust, someone that they can incentivize? And if so, that general manager can act in their place as in the owner, even if they don't have equity.

Dan: Got it. So we are in the middle of probably a historic labor shortage and nobody can hire anyone to do anything. I'm curious how many locations you might have in the portfolio already to kind of give us some framework on. If you're currently experiencing labor shortages that a lot of people are talking about here on the news or maybe you're kind of immune to that or maybe these franchises have such a robust marketing system to get labor in the door to help hire these general managers and, obviously, the workforce that is at every level in the company. What is the solution, if any, or just the feedback of the general labor market from your perspective in the franchise world?

Jon: Yeah, I'd say the labor market is very similar to non-franchise. It's tough right now. As a business owner, you're playing whack-a-mole. And right now, the mole is on the labor side. There's huge customer demand, really across Industries and we're seeing that with their own businesses. But the challenge is finding people and finding the right people and keeping them. There's something that we did in some of our services businesses with my partners. We had to implement a weekly bonus that we pay strictly for hitting all five of your shifts that week. So if you show up every day and you complete your shifts and we'll give you an extra $7,500.

Dan: [laughter] Wow.

Jon: And it ends up, gain maybe $2 per hour. The math works on our end because we're also in turn raising our prices. It's no lie to any of your listeners that we're in an inflationary environment right now. And the great thing is we are able to raise our prices, just like you raised your rents on real estate. So we're not necessarily raising the full amount to offset on the labor side but, as unemployment gets wound down, things have to change at some point.

We probably can't walk back that extra money that we're paying, but we're going to do is add that in the additional criteria to be able to hit that goal. In addition to showing up, you also have to do a couple of additional things on top of that. So yeah. But hey, everyone is aware of the labor challenge out there right now. You can still find good people but it just takes a little bit more effort to do that. [tongue clicking] And so, a lot of my clients do say, "Hey, what are those concepts that require the fewest employees to still make a good bang for the buck. That's a very common discussion we're having.

Dan: Got it. And what are the industries for something like that, fewest employee requirement?

Jon: Yeah, again, I shy away from food. I really focus in other sectors. And I'd say food is obviously employee-heavy. I mentioned the driveway business. That's an example where you have very little overhead. You have a commission sales person. You have one or two people on the fulfillment side on the backend. Within the oil change business, that's two people per location. Can you staff up to that? We've got a great dumpster business which, essentially, it's guys out there driving the truck.

Another one is doing sales and marketing. And so, I think if you can keep it to a manageable group and then you're going to end up, probably paying a little bit more now than you typically would in this environment, but you can also charge more. So it's just a shift and, really, people understand that when we raise prices in our home cleaning business, we positioned it to our customers. We're doing this. They know what's going on out there. And we're saying, "Hey, we're having to pay a little bit more to have the best people out there to service you." And they'll gladly pay that. We really didn't lose any meaningful number of customers when we raise prices. They get it.

Dan: Yeah, it's interesting. Interesting, the ways to deal with the challenge. There's like this incentivization. I don't know, maybe this new trend, Jon, just like systemically in business and all together. I've typically tried to approach all of my people as business partners and we have this like business partner split. We do a deal. We all three of us are working on this deal and we'reh splitting the profit or the loss on that deal. And that's how it's shaking out rather than here's the salary and then all the upside stays with corporate. Maybe there's this solution like you're saying where it's $2 an hour or the GMs are getting these profit-sharing bonuses. I mean, I wonder if there's some trend toward aligning the incentives at some level, almost at every level of the business as opposed to just management executive and ownership levels there. Just a thought I guess.

Jon: Yeah, I did have a learning a few years ago with a business that I was running where I said, "Hey, let's do a quarterly profit-sharing plan." This was for hourly employees. In that case, that didn't resonate. Three months can be a very long time to someone that's living paycheck to paycheck or close to it. And I realized what they use as a comparison between different opportunities in the market was more of that rate per hour. So I had to translate it back to speak their language. Now, on the flip side, we recently hired a GM for one of our businesses and we offered him three options. Always like to give options. You could take a $90,000 base salary, $80,000 or $70,000. If you take $90,000, you get 10% of earnings. If you take $80,000, you get 15%. If you take $70,000, you get 20%. And guess what he chose? $70,000 and the 20%.

When they checked that box, it shows they believe in the business but you definitely have to gear it and speak the language of the individual level.

Dan: So is that $90,000, $80,000, $70,000 10%,15% earnings, is that an interview question? Is that like a test for you to see, if I'm like all things are equal between two candidates and one is answering that question a certain way. That might tip the scale.

Jon: Yeah, we didn't ask it to multiple candidates at the same time. So it wasn't for comparison, but no. I totally agree with you. I like it as an interview question. For us, it was really that last step of negotiating the agreement. We'd gone through several rounds of interviews. So we probably would have taken them at $90,000 and 10%, but we certainly liked his answer.

Dan: Yeah, it's a total fantasy world that we have two well-qualified candidates sitting in front of us. I can't remember when that happened. [laughter]

Jon: [laughter] Back in the day. That's how it was, right?

Dan: Yeah, I guess. I miss that one. So, what are the risks, Jon? How can I lose my money? Why would a market not accept my business model? What are some things that could happen that are going to turn this into a bankrupt situation?

Jon: Yeah. Well, first off, we want to be wise about what we're investing versus what our current assets are. You don't want to over-extend. But if there are comparable markets out there that you can point to and people with similar backgrounds that are buying into the system and they're doing well, it doesn't guarantee your success because it certainly increases your likelihood of it. What I tell clients often times is, "Hey, let's look at the absolute downside." Say, for whatever reason, maybe you get sick once you start the business and realize you can't run it or just have no interest in it or it's just not taking off. What is the downside? Typically, you can resell that business. If you built it at all, you should be able to sell for at least what you paid for it.

But let's say it just hasn't done, well, maybe you have to take a haircut, but you're still going to have some residual value for that business based on that franchise system that someone out there can be willing to pay and, maybe, the neighboring franchisee could be, you know, if you're in East Chicago, it could be that Northern Chicago franchise owner and says, "Hey, I'd love to expand and I'm kind of landlocked right now. But yeah, if you want to give it to me and maybe take a haircut on it." And so, in most cases, there's minimal downside. Your risk of losing everything is fairly minimal. But again, if you go out and you open 10 brick-and-mortar locations, you have a massive capital investment and you're highly leveraged and it's not a proven brand, you would incur a little more risk.

Dan: Yeah, and I think it's probably smart. I think I'd shop for franchises one time in a magazine that I bought somewhere, which franchise monthly or whatever it was and I remember paging through it. Maybe it was like Entrepreneur Magazine or something back and I cringe now having a conversation with you, who has more experience and shopping for franchises being in the seat that you're in. And I cringe at the thought of people responding to an ad in the back of that magazine. And that's the extent of how they're shopping for these franchises is by this very top-level, probably not in-depth, limited amount of experience with all these different brands and probably assuming very limited ability to analyze the risk and analyze the pros and cons of specific franchises just by the nature of them digging into an ad they found in a magazine. So that would also be a risk, right?

Jon: Yeah. I mean, ultimately, there's 4,000 franchise brands out there in the US. What we have done is we have vetted them, taking them down to a portfolio of 300 that we have chosen and represented, At times, we'll drop some and bring others in. And then, I really go deep with the ones that I would buy into myself and pick out. I'd say there's probably a list of 50 that I really know like the back of my hand. I was down in Florida with a 150 franchise orgs two weeks ago. They were all sharing with me what's going on the backside, what they have coming up. I mean, we do this every six months and I'm constantly sighing, "Hey, these are my top 10. They are what my client's getting into."

I think for me being able to put myself in my client's shoes because I'm a franchisee. I'm a former franchisor and I used to be in the corporate world and I've invested in real estate. I know what it looks like the day-to-day for them and just love having those conversations and help and guide them through the process because it can be overwhelming not knowing where to start. And once you really understand what's going on in the backside, you can really get excited about the right opportunities. [deep breathing]

Dan: Yeah, I like in or I guess the metaphor, the bridge I'd make with what you're doing and your background and actually owning some of these things is like a real estate agent who actually does flip houses, selling you a flip or a real estate agent who actually does own rental properties, selling you a rental property investment. In most cases, you're not going to have to come out of pocket to pay that agent just like you're representing the company and the company kind of pays. They got that listing side is where...

Jon: Exactly.

Dan: ...your incentive is. And it's, again, another cringe-worthy thing to think like the 23-year-old kid is selling a rental property to someone and it's their first run. So I'm like, "Oh, man. That could be like a really, really dangerous situation. Jon, any other questions I did not have the insight to ask that you feel the audience might be thinking?

Jon: I think you hit them head-on. That was a great discussion. I would be more than happy to chat with any of your listeners. Like I said, entirely free. Let's jump on a 15-minute call, have a discussion, hear a little bit more about your situation. I'd love to fill in some of the knowledge gaps. And then, ultimately, if this is something that you feel serious about, happy to take you through the process. I love playing matchmaker. Again, I do what I do and would love to connect with anyone. Feel free to reach out to me, jon@franbridgeconsulting.com or visit us on our website. Sign up for our newsletter. Connect with me on LinkedIn. I would love to engage.

Dan: Nice. Are there any book recommendations you'd have in closing, could be franchise, could be real estate or anything else comes to mind?

Jon: Yeah, I've actually got my own franchise book that's in the works, The Franchise Path. It's done. We just have to literally get it out the door. So excited about that. But The Franchise MBA is a great book. I wouldn't overthink it. I think some people overthink things, do a little too much research on the front end. Our whole model is streamlined to make it easy for you. But then, one non-franchise book I mentioned is The Compound Effect by Darren Hardy. I've read it multiple times. It's one of my favorites. [tongue clicking] My wife, lets me pick a book every year for her to read of one of the ones I've read the previous year and I've had her read it I think twice now. But it says, "Little decisions day-in, day-out, that just add up over time." And so, anyway, that's one of my favorites, The Compound Effect by Darren Hardy. [deep breathing]

Dan: Nice. So Crown Jewel was from Jon. How long have you been in there? You said what was it, five, 10 years, something, for the franchise thing?

Jon: I've spent most of my career in the corporate world, and I've got into franchising a little over five years ago and never looked back. I absolutely fell in love [inaudible]. Love helping others achieve their dream and I understand, yeah, this other path to business ownership.

Dan: So you do go back five years ago, you were just leaving corporate America and you could share the Crown Jewel of Wisdom with yourself at that moment, knowing everything you know now, what would you tell yourself?

Jon: Back then, I'd say, "Activity breeds activity. Get off the sidelines. Get in the game. Don't feel like you have to have it all figured out on day one. If you start moving towards option A or option B, very oftentimes option C comes out of the left field." And so, a principle in my life is once you get in the game, get active, good things happen.

Dan: All right, cool. Any other final asks or thoughts as we wrap up?

Jon: No, excited about what's going on in franchising. We're seeing massive, massive growth coming out of Covid. And if someone is thinking about business ownership or diversifying their investments, would love to help you understand what this path looks like. [deep breathing]

Dan: All right, sounds good. Hey, thank you, Jon, for coming on the show. Had a blast. Got a ton of value and notes myself. So I appreciate your time.

Jon: Absolutely enjoyed the discussion.

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We are at the conclusion, my friend. Next up. We have Victor Uracheck[?] joining us to discuss his start in flipping houses in 2018 and then quickly ramping up to doing 20 to 30 flips per year since then. So I'll catch you and Victor next time.

[music]

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