Myth vs. reality in franchising

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August 2, 2021

Last month, President Biden's nominee David Weil participated in Senate hearings to run the Wage and Hour division of the Labor Department. If confirmed, Weil's long-term opposition and inaccurate views on franchising have the potential to affect a sector with approximately 730,000 establishments and 8.4 million workers.

Weil's central thesis is that in contrast to an idealized past in which large, vertically integrated employers dominated the American economy, today's labor markets are characterized by a "fissured workplace" in which employers have shed all non-core employees in order to reduce wages.

Specifically, his attacks on franchising are centered on fast food restaurants, janitorial services, and hotel services, although anyone that has done their research on franchising is aware that this community reaches a host of additional industries, such as child care, home improvement, fitness, and hair salons.

Weil presents a handful of horror stories, but he doesn't produce any evidence that franchise businesses pay less — because there aren't any. In fact, there is evidence to the contrary.

A forthcoming report from Oxford Economics provides a fresh picture of franchising in 2021 and should convince Dr. Weil to update his beliefs. The survey was commissioned by the International Franchise Association, an organization that I consult for. The Oxford research team recently surveyed more than 4,000 individual franchisees across a vast array of industries, and asked comprehensive questions about compensation, franchisor support, and involvement in the local community. In addition, the research team used arm's-length data from payroll company Homebase to examine wages and wage growth.

One of the mechanisms in the fissuring thesis is that franchisees have incentives to take short-cuts – including low wages -- because they can free-ride off the brand's reputation. The Oxford analysis of wages and wage growth compares franchised businesses to individually owned-and-operated businesses in 2018 and 2019, prior to the pandemic. Small, independent business owners have very strong incentives to maintain their reputation, where postings about worker mistreatment can lead viral stories and loss of customers. Yet the analysis found that wages and wage growth were *virtually the same* for newly hired workers in franchised businesses and independent ones. Wages grew from approximately $10.30 per hour at the start of employment to around $11.10 per hour after 20 months, with no more than a 13 cent difference in any month. Moreover, newly hired workers in franchised businesses were more likely to be promoted to manager. The confidential survey of 4,000 franchisees found that the share of workers offered various benefits at small franchise firms was roughly on par with the share at small non-franchise establishments. This data-driven descriptive evidence presents no support for the fissuring hypothesis.

The franchisee survey also rebuts perceptions of exploitation of franchisees. Overall, 32 percent of respondents report they would not own a business if they were not franchisees, with a higher percentage among female owners. The Oxford team calculates that without franchisor support, approximately 223,000 establishments employing some 1.8 million workers wouldn't exist if franchising was not an option. The survey also found that franchisee training, meetings and events, and technology platforms were the most important areas of franchisor support. Intuitively, these responses are consistent with the idea that franchising provides a path to entrepreneurship, and many owners wouldn't have gone down that uncertain path without such support. Small businesses such as these help promote competition and increased variety for consumers.

There is no doubt that an occasional headline about a specific brand or location may document legitimate problems, but the Oxford report shows that the franchising model works. As Weil himself notes, franchising "has proved a powerful means to tap capital and entrepreneurial drive of new business owners who seek opportunities to expand an established product or service." Franchisees value the support from franchisors, and the differences in working conditions with other business models is negligible. With more than 730,000 franchise locations, spanning thousands of brands among 230 industries, and supporting more than 8 million jobs, nationwide regulatory policy shouldn't be guided by a handful of outliers.

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