# Franchising of market sectors

Briefing

**POEMs (Public Official E-Markets) is an imagined online platform enabling trading in thousands of sectors. Each sector could be developed by its own independent franchisee; one person running the market for window cleaning, another individual motivated to grow childcare activity, someone else vested in attracting rental of horticultural land to POEMs, and so on.**

**Franchising each sector should deliver local control, targeted entrepreneurship and lower start-up costs for a consortium running the system core. It could be mandated in the legislation that establishes POEMs.**

NERD ALERT

McDonald's Hamburgers is the best-known organization that harnessed franchising to achieve consistency and high operating standards while growing rapidly. The corporation evolved a nuanced rulebook that allows suitably qualified individuals to purchase the right to operate a McDonald's in a given area. It ensures a replicable brand experience married with local drive and innovation.

We **don't need to know any of this** to enjoy a Big Mac and Fries. Customers simply intuit that a McDonald's anywhere in the world will be predictable, clean and understandably priced. It's the same for POEMs; users likely won't care how the system's operating entities are structured. But, if franchising works, they should instinctively feel the dynamism-within-consistency of a huge operation.

There are many reasons POEMs should be federated between a core consortium running central servers and an ever-evolving network of franchisees designing and growing each front-end market. POEMs' rulebook would be determined by the enabling legislation and priorities of the winning consortium. It will have to manage complexities far beyond issues in fast-food. But the McDonald's model is a useful pathfinder.

## Aims of franchising

Legislation initiating a privately funded POEMs could broadly mandate two options for the structure of entities who deliver the service:

- No controls: A consortium who win the concession to operate POEMs are free to run the system as a **monolithic entity**, directly controlling every aspect of the service.

- Franchising mandated: The core consortium runs the enormously sophisticated servers that sit behind front-end interfaces. But each sector within POEMs is to be overseen by an independent franchisee who exclusively purchases a **stretch of "virtual storefront"** from the consortium. One person buys Sports Tuition, another purchases Construction Equipment, a third gets Hire of Musical Instruments, and so on.

We propose the second option. Why not simply allow a winning consortium to operate the entire POEMs system as they wish?

- **Dissipated control**: If a POEMs instillation succeeds, it could transact 30% or more of GDP. That is too significant a chunk of the economy to be at the mercy of one organization. Franchisees who have purchased a stake in the business and need to grow their part of the operation provide a **counterweight** to incompetence or corruption in the core consortium.
- **Local ownership**: The consortium that wins a POEMs concession will need large-scale finance, technology and operations. Providers are likely to be multi-national. That can be good; international companies are less likely to be cowed in event of any unwarranted interference by government. But POEMs needs to reflect the geography it serves. Franchisees turn it into a **federation** of local businesspeople underpinned by a consortium.
- **Innovation within the system**: McDonald's Fillet-O-Fish was initiated by a Cincinnati franchisee worried Catholic customers were avoiding his outlet on Fridays. POEMs needs this ear-to-the-ground sensitivity across its diverse array of sectors.
- **Lower start-up costs**: Franchisees buying their front-end market provides early revenue for the core consortium.

> What eventually separated McDonald's from the rest of the pack was [the founder's] ability to marshal the efforts of hundreds of other entrepreneurs – his McDonald's franchisees.
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> **McDonald's Behind the Arches:** 1986

## What would franchisees do?

Each franchisee should be motivated to grow activity in that sector using a combination of; (a) sales and (b) aligning POEMs' array of software tools with the needs of their sellers, buyers and other market actors. Take, as an example, the franchisee running POEMs' market for Laboratory Rental.

That person starts with the benefits of official backing for POEMs. So, government operations covering forensics, food safety, pathology and academia are driven to buy/sell any laboratory capacity in POEMs. From that starting point, an ambitious franchisee will want to:

- **Prioritize a list of further prospects**: Food companies, pharmaceuticals suppliers, independent medical facilities, researchers and testing institutions for instance.
- **Raise POEMs' profile with prospects**: Speak at their conferences, seek coverage in their publications, meet with industry leaders.

- **Understand of how transactions work in the sector**. What mechanisms will best lubricate trading? Auctioning of lab. time? 3D modelling tools accompanied by per-hour fixed rates? What issues tend to derail intended lab. rental bookings? How can POEMs' tools mitigate?
- **Research current market dynamics**: Over-supply? Uncertain demand? Poor quality? Lack of pricing data? POEMs is going to apply its **core tools** to every sector, doing much to solve any of the above. But a communications plan, perhaps selling benefits of by-the-day lab. hire could widen activity further.
- **Map reliance on supporting sectors**. Transport of samples from operating theatres to testing laboratories, for example, is a specialized part of the courier market. Should lab. owners be encouraged to enter fast-track instructions for getting a body part to the scientist's bench? That could seamlessly become part of POEM's market for medical couriers?
- **Seek new sources of supply or demand**. Might there be a market for home-laboratory facilities traded between amateur scientists? Could high-school science classrooms grow the market? Are back-of-a-van portable labs a viable sub-sector? POEMs Maximum Transaction Size formula incentivizes franchisees to constantly unearth small resources like this.

As at McDonald's, the franchisee is **tweaking a standard offering** rather than designing a service. And there will be resources at the core. It's likely the consortium will have departments liaising with organizations such as universities across each institution's varied range of activities that could touch a POEMs' market. A franchisee might bid for a share of the consortium's national advertising budget by building a business case.

The consortium should be free to select franchisees as they wish; likely based on previous business experience and knowledge of the sector they seek to run. Franchisees will be in "co-opetition" with adjoining franchisees; as three McDonald's outlets in one town might draw business from each other, but unite in competing with Burger King or KFC.

## Rules for franchising

To achieve the aims above, legislation enabling POEMs could mandate:

1. **Two sets of entities**: Any reference to POEMs' "Operators" in the legislation covers a combination of (a) a core consortium who win the concession to operate POEMs (b) their franchisees who buy part of the business. Both must operate within the legislation.
2. **Split functions**: Members of the consortium are not permitted to design or oversee any screen with which users (other than consortium staff) interact. Franchisees may not commission or operate any processing functionality that sits behind a screen or design their own screen elements; they can only draw on the consortium's library of functionality and display elements.
3. **Rights of both parties**: The consortium decide how to divide sectors for franchising, who is permitted to be a franchisee and on what grounds a franchisee is to be replaced. Franchisees can form associations as a counterweight to the consortium's power.

4. **<u>Characteristics of franchisees</u>**: Franchisees must be individuals, perhaps they have to be citizens of the country, or region, POEMs covers.
5. **<u>Revenue share</u>**: System income from a specific sector is shared between the consortium and the sector franchisee. The formula for this is at the discretion of the consortium but operating the front-end themselves is not an option; they have to attract franchisees. (This income is the 2% or so mark-up added to the price paid by the buyer for each transaction.) The consortium is also obligated to fund a franchisee for non-revenue services mandated in the legislation. It is in the consortium's interest to incentivize growth in these sectors; it boosts system attractiveness generally.
6. **<u>Transparency</u>**: As with all POEMs' operations; details of individual franchisees, their renumeration formula, and turnover is published.

## Possible model: splitting of franchises

There is a further refinement of POEMs' franchising that maximizes the aims of a federated system. McDonald's upheld standards by eschewing territorial franchises. And restaurant operators were largely the owners. You could buy the right to operate a McDonalds at one location, but not the right to run McDonald's across New York City.

This limited the impact of an underperforming franchisee while ensuring motivation on the front line. POEMs could adopt the same principle. But it will have to encompass what could be rapid growth in some sectors. Even a tightly defined early franchise in POEMs could turn into an unintended land-grab if a sector grew unexpectedly.

Splitting of franchises offers a way to keep franchisees rewarded but without any one person gaining the power to control a vast swathe of the system. The model below assumes that a POEMs consortium – like McDonald's - maintains training and finance sources for potential franchisees. This ensures there is a constant pool of putative takers when a new franchise is made available.

Rules to enforce splitting might stipulate:

- Each franchisee pays a **set fee for their franchise**. For this example, we will assume they pay the consortium $50,000 to get an exclusive franchise for the duration of POEM's concession. They can sell all, or part, of their franchise to other approved franchisees at any time.
- The consortium must maintain a neutral aftermarket in which franchisees can buy/sell franchises.
- A rule is set that each franchisee can earn only **up to a ceiling** in revenue from their market. However, they are able to sell off part of their market to other approved franchisees and there is **no limit** on this income. To make this tangible, let's assume the cap on share of revenue from market turnover is $100,000 a year, adjusted for inflation.
- At launch, the consortium divide their directory of initial sectors into franchises. They are aiming to create franchises that will each reach $100K in earnings for the franchisee within 12 months. The percentage split of system revenue for each franchise is decided by bidding between the

pool of franchisees. So, a market that is specialized with little growth potential such as "Hand made cakes" will probably only find a franchisee if that person retains 90% of the system's mark-up on transactions. The remaining 10% goes to the consortium. But a sector like "Overnight accommodation" clearly has enormous room for growth. The consortium may find a qualified franchisee who will take it for only 5% of the system revenue generated.

- If a franchisee exceeds $100K in their share of revenue in any year, the surplus is diverted from them to the system's "MATS Surplus" fund.

**<u>The model in action</u>**

- Dan has purchased the initial POEMs franchise for "Drivers". He immediately starts outreaching to goods haulers, bus operators, limousine companies and others who hire drivers. He has negotiated 7.5% as his share of each transaction charge in the Drivers market.
- Dan's sales outreach is successful and within a few months he is earning $5K a week. He needs to split his franchise before those earnings reach $100K over a year. He decides to focus on commercial vehicle drivers and sells off the part of his franchise for car drivers (taxis, limousines). It's on a trajectory to fast growth so a pre-approved franchisee pays him $80K.
- Now he has three categories of drivers to focus on: passenger vehicles, trucks and agricultural. Doubling down on the trucking industry, bus/coach operators and farmers he is soon again in danger of passing $100K in earnings from even the new reduced franchise. So, he decides to retain Bus/Coach drivers and sell the rest of his spectrum. That brings in $220K.
- Again, he accelerates growth in passenger vehicle drivers and must let part of the market go. He sees the most potential in minibus drivers and sells the rest of his virtual storefront for $150K. When that deepens to the point he must again split the franchise, he might chose to focus on specialized minibus drivers; those qualified to operate vehicles with lifts for the disabled or amphibious tourist craft or drivers who double as tour guides and so on. If even that small sector grows to the point where 7.5% of 2% on its transactions exceeds $100K, the logical next split might be geographic: Dan retaining the south of POEMs' territory and selling the north.
- So, Dan's hard work has earned him hundreds of thousands of dollars. But his levels of control have remained commensurate with the scale of the market. If he underperforms, another franchisee, or putative franchisee, will likely offer to purchase his business and grow it themselves. If the driver market contracts, after autonomous vehicles are introduced perhaps, it can shrink smoothly. Dan can buy out adjoining franchisees as long as his earnings from transaction revenues remain under $100K a year.

Splitting takes unknowables out of POEMs' launch. Dan cannot divine the eventual value of the Drivers market up-front. So full purchase of the entire market could easily lead to an over or under bid. Either is potentially destabilizing with a franchisee underwater financially as demotivated as one who is effortlessly earning far more than the value they purchased.

Splitting ensures franchisees get increasingly specialized and responsive to their sector as markets grow.

As an added refinement; the enabling legislation may permit the consortium to directly operate front-end markets for perhaps the first year of POEMs. This reduces complexity of operations at launch then allows the consortium a period to set benchmarks and respond to immediate user feedback without having to negotiate changes with franchisees.