

The Millionaire Machine:

Franchising has quietly made countless Americans rich

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WHEN GREG FLYNN graduated from Stanford Business School in 1994, with the dotcom boom in full swing, his friends chose the obvious career path. But while they “were all making PowerPoint presentations...becoming paper millionaires,” he went off to help a friend open a second restaurant. A few years later, spotting generous financing on offer for would-be franchisees, Mr Flynn bought eight Applebee’s restaurants of his own. He now runs more than 3,000 franchise outlets across seven brands in three countries, and is reportedly worth over \$1bn, making him probably the first franchisee in the world to reach that milestone. On February 22nd the International Franchise Association, a lobbying group, inducted him into its Hall of Fame—an accolade once reserved for franchisors, the innovators on the other side of the business who established big chains, such as Ray Kroc of McDonald’s or Colonel Harland Sanders of KFC.

Mr Flynn’s is a tale of slow and steady success. So is that of the franchise model, which began spreading across America in the 1950s. Nowadays there are close to 850,000 franchise establishments in the country, run by around 250,000 owners, employing some 9m people and generating about 3% of GDP. As many as one in eight businesses with at least one employee are part of a franchise. All kinds of establishments, from Dunkin’ Donuts to the UPS Store and most Marriott hotels, are franchised. Lately the model has been spreading into new areas—such as boutique fitness, home services and child care—thanks in part to private-equity investors that have become enthusiastic franchisors.

Owning a franchise may be the purest distillation of the American dream. Some 95% of McDonald’s 14,000 American outlets are operated by franchisees, and the chain has plausibly created more millionaires than any firm in history. “We’re not all going to be Steve Jobs or Elon Musk,” says Matt Haller, who runs the IFA, but many can imagine themselves saving up to have a go at the all-American business of “slinging hamburgers”. The proposition has long appealed to immigrants in particular: around two-thirds of American motels are owned by Indians, many descended from Gujaratis who bought Super 8 and Travelodge franchises in the 1980s.

Mr Haller says franchisees now report growing interest from their children in succession plans. That is perhaps unsurprising. A decade ago the path to prosperity for young Americans looked certain: a college education and a white-collar “laptop” job. But rising tuition fees and the emergence of artificial intelligence have prompted renewed interest in the trades and other more pedestrian ways to make a living. In-person businesses—teaching Pilates, cooking food—look like a safer bet now. “There’s

really not a franchise that you can run without people,” says Mr Haller. Many more young people, then, may soon follow Mr Flynn’s example. Will it pay off for them?

To economists, franchises are something of an oddity. As Paul Rubin of the University of Georgia noted in a paper in 1978, they blur the boundary between a firm and the open market. Franchisors, who typically maintain control over things such as menus and opening hours, gain a network of motivated entrepreneurs prepared to put down their own capital, allowing the company to scale quickly. In return, franchisees are given the opportunity to run their own business with the security of an established brand.

The arrangement is most common in industries that require armies of physically dispersed employees—serving food made to order in thousands of locations, or running hotels. Letting the franchisee keep the profits, minus the royalty, gives them reason to work harder than a salaried store manager would.

Local knowledge is another advantage. Roads have “dinner sides” and “breakfast sides”; opening a coffee drive-through where people pass on the way home, not on the way to work, is a bad idea. Some locations are what Dinesh Goswami, who operates more than 100 outlets across Taco Bell, Dunkin’ Donuts and other chains, calls “Statue of Liberty” spots—highly visible but hard to reach. He opened a Popeyes in Nashville that customers could see from a mile away, but it was so hard to navigate to from ground level that revenues quickly collapsed by 60%.

Mr Flynn bought his first eight Applebee’s outlets, in Washington state, from a franchisee based in Cleveland who insisted that “the way I do things in Ohio is the way I want to do them in Indiana and New Jersey and Washington.” When Mr Flynn took over, Dan Krebsbach, a local employee, told him the restaurants could do better. In the Midwest, Applebee’s was a family joint; but in Seattle, Mr Krebsbach told him that “there is an opportunity for a great chain of bars.” He also wanted to increase staffing levels. Mr Flynn agreed to do things Mr Krebsbach’s way, offering him a profit-sharing arrangement—a sort of franchise within the franchise.

“The business, frankly, turned on a dime,” Mr Flynn recalls. Revenue jumped by a third. He opened two more Applebee’s on Mr Krebsbach’s recommendation. They boomed as well. Mr Flynn called the Cleveland owner and offered to buy the rest. “We bought 62 more. We went from 10 to 72 overnight.” Today Mr Krebsbach runs all 460 of Mr Flynn’s Applebee’s. The Flynn Restaurant Group operates on what its owner calls a “state and federal” model: regional managers share profits and run their local markets, while the head office handles areas such as finance and training where there are economies of scale.

Bert Albertse, boss of Jetset Pilates, a chain of more than 100 studios, also sees the benefit of franchising at first hand. “None of the corporate units are top-quartile performers,” he says of the studios his company owns directly. “Every single one of them is below average performance relative to our franchisees today.” One of Mr Albertse’s franchisees, Justin Clonts, who works in private equity while owning and

operating three Jetset studios in Manhattan with his wife, says “there is no way we would have opened three studios within a 12-month period” without being part of a franchise. He points, for example, to the guidance they received from the chain on hiring and digital marketing.

The terms on offer to franchisees are remarkably easy to look up: any business selling a franchise in America must produce a Franchise Disclosure Document (FDD), and several states publish their registries. FDDs disclose the many fees a franchisee must pay—including both upfront and ongoing payments—and can include detailed data on how existing franchisees are performing.

Leafing through a dozen or so FDDs reveals that they have much in common. Ongoing royalties to the franchisor are typically paid as a share of sales. So are other fees such as for marketing. Together these amount to perhaps 5-7% of sales for food-service businesses and 10-12% for beauty and fitness. The initial fee paid to a franchisor to open a single outlet is usually tens of thousands of dollars, and often \$50,000 or more, with discounts for multi-unit purchases. That is before any money has been put into renovations or equipment. Total opening costs vary widely: a food-service restaurant tends to run north of \$1m; a fitness studio \$300,000-800,000.

That is serious money. Some franchisees raise it from friends and family, in the manner of the Gujarati motel-owners; others use the savings from a first career. Patrick Buckley, a franchise analyst, says most successful franchisees he has met funded themselves through a mix of loans and a raid on their retirement savings.

As with all business ventures, there is a decent chance of failure. When comparing franchisees and independent businesses, “the difference in survival rate is small”, says Francine LaFontaine of the University of Michigan, and is present only for the first year or two. After that the likelihood of staying in business is about the same.

Yet the risk varies significantly based on the type of franchise. “The chances of succeeding with a new restaurant are much greater if you’re part of a franchise that has worked out the systems, has high brand awareness and a huge marketing budget that’s helping you,” says Mr Flynn. And even if it doesn’t turn out as well as the franchisee hopes, there is often the option to sell the business on. “There are liquid markets for franchises,” explains Mr Flynn. That is less true for newer franchises that are still establishing their brands, however. The rewards can be far bigger (early adopters get better territory) but so is the risk.

The structure of the franchise arrangement also matters. When Ray Kroc took charge of McDonald’s, most other franchisors at the time made their money selling supplies or charging a licensing fee, rather than the revenue-sharing model that prevails today. “Once you get into the supply business, you become more concerned about what you are making on sales to your franchisee than with how his sales are doing,” Kroc argued.

This approach still causes problems when it arises. Many franchisees ended up failing under the model run by XPonential Fitness, the former owner of CycleBar, a fitness chain, which required them to purchase pricey equipment from it at a profit. In March the Federal Trade Commission announced that the company would return \$17m to franchisees as part of a settlement with the regulator over violations of franchising rules.

Another criticism of franchises focuses on their impact on the many low-paid workers they employ. In his new book, “Chains of Command”, Brian Callaci of the Open Markets Institute, a think-tank focused on competition policy, argues that the distinction between franchisee and employee is a legal fiction because of the extent of control exercised by franchisors. And given how little power they have, the only way franchisees can make money for themselves is to pay their workers as little as possible, according to Mr Callaci.

The clearest evidence that franchising has harmed low-wage workers comes from no-poach clauses, which once restricted hiring between outlets in the same chain. In 2018 the late Alan Krueger published a paper showing how common such clauses were in franchises and arguing that they suppressed wage competition. A number of states began investigating and the practice was eventually abandoned. Research by Mr Callaci in 2024 found that eliminating no-poach clauses had raised affected workers’ wages by 4-6%.

Beyond the no-poach example, however, evidence of broader harm to workers is hard to find. In another paper Krueger found that wages for front-line staff were about 2% lower at franchised outlets than at company-owned ones—a gap he called “trivial”. And the suggestion that franchisees are employees in disguise sits awkwardly with the existence of operators like Mr Flynn. (Mr Callaci, for his part, notes that where franchisees have more power, workers tend to earn slightly more.) In 2015, during the Obama administration, a “joint-employer rule” was introduced making franchisors jointly liable for their franchisees’ workers. But it was never upheld in court, and the rule was narrowed to cases of “direct and immediate control” in 2020 during the first Trump administration. An effort in 2023 during the Biden administration to relax the more restrictive definition was unsuccessful, and in February this year it was formally reinstated by the second Trump administration. Franchising is “an engine of opportunity”, argues Mr Flynn. America’s politicians would be wise not to tamper with it. ■

Correction (May 29th): An earlier version of this article said that one in six American businesses with employees is part of a franchise. In fact, it is one in eight.

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