Funding The Franchise Business

Both the franchisor and the franchisee have their own ends of the franchising costs to pay for and it is important that they are both aware of just how many items they must consider before embarking on this route.

Funding for the Franchisor

For those who decide to build their business through franchising, one of the biggest obstacles is the added cost and the level of funding therefore required at the initial stage. Anyone who is considering growing their business through franchising should give full consideration to the following cost items:

a) The pilot operation

The franchisor must have operated a successful test operation before franchising the business. Funds will be required to do this.

b) The operating manual

A thoroughly prepared operating manual must be written before franchising commences. This will certainly involve a considerable period of time and may also require an input from a consultant and/or other/s with appropriate expertise.

c) The franchise agreement

Whilst the franchisor will set out the terms of the agreement, a lawyer must be retained to fine tune it and constitute it as a proper legal contract.

d) Promotional material

The writing, design and printing of a range of good quality promotional material for the franchise pack for prospective franchisees must be funded.

More than all the above, perhaps, is the quantity of management time that must be dedicated to the development of the franchise concept. Apart from the franchisor's own time, additional management resources and a strong team will be required to provide back-up and support for the franchisee network.

Funding for the Franchisee

The franchisee should budget for the following cost items:

a) The initial franchise fee

This fee will depend on the structure of the package. In its simplest form, the initial fee includes services to assist with start-up, initial training and the purchase of the franchisor's "goodwill" along with the right to use the brand name. In more complex arrangements the franchisor may acquire and fully equip the premises and, upon completion of the franchisee's training, hand over the "key" to the franchisee. This is called a turnkey operation and the initial fee is based on the cost of the elements included in the package, including training, plus a mark-up for the franchisor.

b) Capital investment

The franchisee must also fund the fit-out of the business in accordance with the specifications of the franchise package. For the job franchise this may entail little more than the purchase or lease of a van or truck and some small items of equipment. In some of the large retail franchises, however, the securing and refurbishment of premises and fit-out can represent a sizeable cost for the franchisee.

c) Working capital

A franchise business is no different from any other in that the franchisee will have to fund the initial start-up expenses until revenue from customers builds up. The franchisee will, however, benefit from the learning experience of the franchisor and the other franchisees, and will thus have a more accurate picture of working capital requirements. In addition, the recognised brand name of many franchise systems often results in faster customer acceptance of the product or service in question.

d) Continuing fees

The management services fee (MSF) charged to franchisees by the franchisor provides the latter with his or her income. (A franchisor must always remember that these fees are based on turnover, not profit).

A franchisor may also require a franchisee to make a contribution to a marketing or advertising levy which funds the cost of national marketing and advertising for the network.

Any prospective franchisee should carefully assess all of the above costs and on-going fees when evaluating an opportunity to ensure that he or she will receive an adequate financial return from the franchise system in question.

About the Author

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