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A Rose by any other Name — A Move away  
from the Traditional Franchise Model  
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## The

term “Franchising” has always had a very specific meaning and referred to a defined business model. When doing a recent article on franchising in the service industry, I noticed that it was an excellent illustration of the metamorphosis of the traditional franchise model. That traditional model; initial fee, royalties and advertising fees, just isn't the standard anymore. The model has become very flexible and franchisors are finding creative ways of designing the model that makes their system more efficient, easier to operate and a better target for prospects.

The traditional franchise model has franchisees paying an Initial Franchise Fee and perhaps, an additional Training Fee at the outset. These fees represent; the right to use the Trade Mark(s), and a re-imburement of the cost to the franchisor of putting the franchisee into business. Contrary to popular belief, this is not a profit making centre for the franchisor. The franchisor incurs tremendous expense evaluating the prospect, selecting the site, coordinating the turn key process of construction and training, as well as the cost of the legal work. The Training Fee may be a separate fee and may be offered by another professional service. This part of the tradition remains in the majority of systems as the cost of starting a business is still the same in any model. In some cases though, this cost is actually rising significantly, or disappearing altogether. One reason it would increase is where the franchise is a service franchise, such as a local newspaper for example, and there is a lot of up front technical and sales training that has to occur as well as the delivery of substantially the entire business model up front. Franchisors sometimes make it disappear to attract more prospects, which can be a risky strategy. However these fees are often made up over time, or are assumed as a business investment loss to assist growth. One less barrier to entry in a very low investment opportunity is a surefire way to guarantee that the franchisee's money is going to be used as working capital for developing the business. Just make sure that the franchisee is well qualified if he or she does not have to put money down to get in.

Next, as an ongoing financial commitment, franchisees generally pay a certain percentage of their gross weekly/monthly sales as royalties, and a smaller percentage as advertising fees. Often, there is an additional local store marketing component. In this new model, there are no such royalty fees, and ad fees are a fixed amount per month, say \$500.00 for example, or any new combination thereof. There are multitudes of creative ways that the financial model has been restructured to suit the needs of each individual system. In most cases, it's because there is a product involved in the supply chain and the franchisor is at the top of, has control, or can have control, of it. The franchisor may sell the finished product, raw materials, or even just manage the relationship of the chain of supply. So how does the franchisor make money? The franchisor derives its revenues from the sales of product. Instead of making money on the product as it goes out of the system (i.e.: royalties), it makes it on the product as it goes in. If the franchisor is just a middleman in the supply chain then the franchisor is

remunerated by the supplier, or the franchisees buy directly from the franchisor who bulk purchases from the supplier. Essentially, it is more of a distribution style model in many ways. In a distribution model, each party takes their share of the price as the product moves through the channel. It works particularly in franchising since the key to franchising is consistency, and the franchisor is best placed to ensure that.

One of the best reasons to structure a system this way from the franchisor's perspective is the steady cash flow. Having been a franchisor myself, I know what it is like to have to collect royalties. Having worked for many years with a master franchisee, I understand the franchisee's frustration as well. With this system, the franchisor is being compensated as merchandise is purchased and the franchisee receives it and pays with royalties all factored into his cost. There is no monthly cheque writing or debit to his bank account. There is less accounting and paperwork on both sides. The franchisor has a steadier cash flow and is being paid regularly as the franchisees are purchasing regularly. There are also less payments to collect and less chance of default. It is this monthly collection process that is the bane of every franchise relationship. The other benefit of this method not to be overlooked by any means, is the operational ability to monitor the inventory and cost levels of franchisees if the purchasing is done through the franchisor. By moving towards a supply chain management model you eliminate the "bad" part of the franchise relationship and create a better financial and operational mold that builds a healthier and more successful system.

The biggest concern I hear when franchisees come to me having investigated a system of this ilk, is that the franchisor will take advantage of its position and charge higher prices for the products or, not pass on rebates that they receive from suppliers. I must first note that supplier and volume rebates are legitimate sources of revenue to a franchisor. A franchisor does not live by royalties alone! As long as the franchisor is honest about the fact that they get them and they keep them, that is the best you can ask for. The money is used for the benefit of the system to fund franchisor's research and development, new projects etc. Often though, franchisors will pass on opportunities to the franchisees. He wants each franchisee to make money. It is in the interest of the franchisor for the franchisee to be as successful as possible so as to attract new franchisees and hence, grow the entire system. Franchisors that lose sight of this and try to make all their money on each product instead of going for the volume, and keeping their eye on the long term, quickly see their overall sales decline as the number of franchised units decline and sales in existing units stalls. The best salesman is a happy, profitable franchisee.

Typically, franchisors do not actually handle any merchandise but have set up buying programs with suppliers. Franchisees benefit from the volume buying power of the group. The franchisor gets a percentage of the sales volume from each supplier as his compensation. In addition there may be advertising dollars contributed by suppliers to the benefit of the system which may be passed on to the franchisor in the form of a cooperative advertising budget, or the creation of marketing materials etc. One system I know of has a centralized purchasing system whereby the franchisees purchase all their computer equipment through the central office. The orders are then placed with the individual suppliers and delivered to each franchisee's location. This allows the franchisor to monitor the franchisee's inventory level and helps them to control costs, a vital part of operational support. Inventory management is probably one of the least understood business principles and one of the most important. Providing this form of assistance to the franchisees is invaluable to their, and ultimately the whole system's, success.

Insofar as marketing is concerned, each system is different but generally, it seems to be a fixed monthly contribution to a regional and/or national fund. Regardless, as is true in a traditional franchise system, all the tools are provided to help the franchisee develop their business. There should always be a database of material to use for local marketing efforts. The advertising fee strategy should remain the same as branding is still crucial. I always recommend a mandatory local store marketing requirement but as a franchisor you still must provide some form of national brand awareness campaign.

The other major area that you see a change in is the move from “bricks and mortar” to other ways in which borders are defined. One system sells postal codes, another, counties, and if you buy an internet business, you get the world as your territory. When there are no bricks and mortar operational standards, that is, how you run your business and deal with your customers, is more personal generally and that creates more latitude as well. This is because these new breeds are mostly found in the service or product+service franchise category and hence, unlike retail, the franchisee must go out and get the customer.

From every other perspective the traditional model works. These hybrid systems provide the level of operational and marketing support needed to ensure success while allowing the franchisee the flexibility to develop the business in their local market. Many of these franchises not only deliver a product but in doing so, also provide a service, and that service part is the important selling feature that differentiates them from their competition. Flexibility in how that service is delivered is often the key to success. In all other respects however, all the other rules of franchising apply. The base is still the same, consistency is the key.

For the franchisor, it is a welcome reprieve from the accounting nightmare of weekly sales and royalty reports, calculations and reminder calls. Everything is paid up front and all squared before the franchisee ever gets the merchandise. This reduces one, if not, the most, contentious areas of the franchise business. By removing an obstacle, you create an environment that fosters communication and that can only be good. For the franchisee, it is an operational model that greatly diminishes the complexity of owning a business, especially where a distribution style supply chain is in place.

I have seen many variations of this model over the past few years and have begun to use it myself. I'm a great fan of a model that solves franchising's most tedious issues. As franchisors continue to find novel ways to structure their systems the franchise industry will grow and open up to a completely new field of opportunities. I can't wait to see what comes next.