

What are you really paying for when you pay your franchise fee?

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Question: I am in the process of buying a franchise and am curious. What exactly am I supposed to get for my franchise fee?

Let's start with some basics.

In the language of franchising, when you use the phrase "Franchise Fee" most insiders understand that to be the initial check you write to the franchisor when you sign your franchise agreement. It's the cost of joining the system and is usually a fairly large flat fee.

My sense of your question is that you really are referring to all of the fees – and there can be many if you read most franchise agreements. However, the principal other fee in franchising – other than the Franchise Fee is the "Royalty Fee" or in some systems the Continuing Royalty. This refers to the checks you will send to your franchisor on a routine basis throughout the term of the agreement. You pay this for staying in the system. While it varies from franchisor to franchisor the Royalty is typically calculated as a percentage of your sales. You may be required to send the payment each month or each week or on some other routine schedule to the franchisor. Many franchisors today don't even need for you to send them a check. When you signed the franchise agreement you gave them permission to reach into your checking account and wire transfer the payment directly to them.

Before I get mail from some franchise purists, the other routine "fee" is usually the "Advertising Fee". This is the payment you will likely make, generally on the same frequency as your royalty payments and typically also as a percentage of your sales. While we call it a fee, and it is money out of your pocket, practically speaking it is not really a fee. Almost always the Advertising Fee is a contribution you are required to make to an advertising fund that the franchisor manages for the franchise system. The franchisor customarily uses the fund to create advertising and marketing materials, in some cases to actually place the advertising and often to reimburse itself for the costs of administering the fund.

Now that we have identified the two principal fees – the Franchise Fee and the Royalty Fee – why are you paying those two? Simplistically, you pay the Franchise Fee for the right to join the club. The franchisor will not let you into the system unless you pay him the initial fee. You pay the Royalty each week or each month to stay in the club. In most well written franchise agreements that is actually all you get – entrance and continual access.

To determine what you will receive from the franchisor you need to read the written franchise agreements closely. Remember, in franchising as in most other contractual arrangements, you only get what your written contract says you get. If there is something your franchisor said they would be providing to you is important to you, and it's not in your written contract, have them amend the contract. They may not be legally bound to provide you that service if it's not in the written agreements.

Essential Thing to Remember: Don't ever – ever – invest in a franchise without the advice of an experienced franchise lawyer. Franchising is a specialty area in the law and while most general practitioners can do your will, they may not have sufficient knowledge in franchising to be really useful to you in deciphering a franchise agreement. Also, and maybe even more important, don't ever accept the advice of a Franchise Broker. They may act like your friend and even refer to themselves as "Franchise Advisors or Consultants" but remember, they don't work for you. They work and get paid by the franchisor only when you buy a franchise. They have a bit of a conflict when it comes to giving you advice.

You will find most of the obligations of the franchisor detailed in Item 11 of the franchisor's Uniform Franchise Offering Circular (UFOC). The UFOC is the thick legal document the franchisor probably gave you during your first meeting with them. Item 11 is a useful place to look since it is written in plain English and typically lists the obligations of the franchisor broken out into two broad categories – those services they will be providing before you open your location and those services they will be providing after you open your location. While it is not truly accurate – some people equate the Franchise Fee they pay with the initial basket of services and the Royalty Fee with the continuing basket of services. Legally it's not but for our purposes it does not really matter.

As an individual unit franchisee, what should you expect to see? It will vary widely from franchisor to franchisor. Within the franchisor's initial obligations, most franchisors will provide you with:

- The right to use the franchisor's system including trade name, service marks and trade décor and operating system.
- Services to help you acquire and develop your location including site specifications, sources of demographic information, site approval visits and architectural assistance (may only be a set of standard plans for you to customize)
- Sources of equipment, fixtures, furnishings, signs, and products required for your business.
- A copy of the franchisor's Confidential Operating Manual
- Initial training for you and your manager and sometimes your staff
- Information and assistance in conducting a grand opening marketing program
- Computer software

- On hand assistance and training at your location prior to your opening for business.

Within most mature franchise system this is just a starting point on the assistance you are likely to receive. How much or what types of assistance you will get depends on the franchisor.

Remember, two franchisors may both provide a month of initial training to you and your staff. However, one franchisor has a training complex which gives you both classroom training and on the job training in a qualified training facility for not only you and your manager but also your initial crew. The other franchisor only arranges for you to work in a local franchise location for the month. Both offer a month of training. Which one would you prefer to receive?

During the operation of your business you will need assistance from the franchisor. During the early days you may need a lot of hand holding and later on, as you become more experienced, your needs will change. Great franchisors provide services differently to different types of franchisees. However, expect to see many of the following services within a franchisor's continuing obligations.

- A requirement to frequently updates the Operations Manual
- Continuing management and staff training opportunities and/or requirements. Great franchisors continually offer training to their franchisees and staff
- Advertising and marketing creative, placement and support locally and system wide
- Research and development on new merchandise and services you will be allowed or required to offer. Good franchisors are always looking for ways to evolve their system in order to stay competitive.
- If you are a retail business, expect to see things like merchandising standards and plan-o-grams
- The opportunity and sometimes the requirement to participate in group purchasing programs for inventory, supplies, insurance, etc.
- An obligation for the franchisor to establish a Franchisee Advisory Council or sub-councils so that you can have input into the management of the franchise system.
- Individual or group counseling to help you improve the operation of your business. Most franchisors provide field visits as well as other types of headquarters and field support. Often these services are provided in a number of ways that don't always include lengthy personal visits by the franchisor's staff. You may get certain services by telephone, by seminar, or by newsletter or bulletins or even via the Internet.

There is no standard list of services you will get from franchisors. Franchisors like McDonalds, Burger King, Arby's and Wendy's are established and mature franchise systems and can provide an immense level of support before you open

and continually once you open your doors. The types of services they provide will even change as you mature in the system.

Other smaller franchisors may work just as hard for their franchisees but cannot afford to provide the same level of services as the big boys. However, if you join a newer franchisor and your support comes directly from the founder of the system, there can often be some real advantages. Smaller franchisors by necessity can often offer a level of personal services that more than makes up for the range of services provided by other larger system.

What you get therefore is not exactly what you pay for. What you get is what the franchisor and you agree to when you sign the written franchise agreement. Every franchise is different and you can't assume that two similar franchisors will provide similar levels and types of services.