



IN THIS ISSUE

Knowing When Franchising is Right

By Craig Frank

Page 2

The Disadvantages of Franchising

By David Gilad

Page 4

Key Franchising Policies

By Ofer Kahane

Page 6

Rules for Successful Franchising

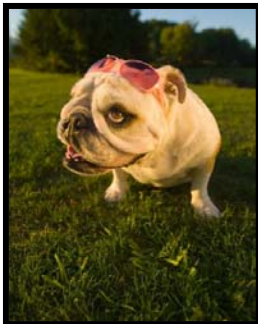
By Ilan Sarid

Page 9

Pricing Franchises

By David Feingersch

Page 12



FEATURES

KNOWING WHEN FRANCHISING IS RIGHT

Last month this space was used to make the case for franchising. The options for companies seeking to expand can include organic growth and developing an affiliates network. Franchising is not the sole possibility, but it has distinctive advantages that, if leveraged properly, can serve to accelerate the pace of growth and establish a commanding competitive advantage.

THE DISADVANTAGES OF FRANCHISING

The hype surrounding franchising can be so seductive that it causes executives considering the option to abandon all semblance of logical evaluation for the promised glory and increased profits. Attending a franchising seminar is like a cheerleading talent show, with presenters offering up frenzied accounts of wild success while asking inane questions about the audience's interest...

KEY FRANCHISING POLICIES

The most critical aspect of franchising is not the sale of the franchise units but rather the policies the franchisor incorporates into the Franchise Agreement. These policies will dictate how the franchisees operate, what they are allowed and not allowed to do, and what obligations are placed on each party. From the franchisors perspective, the more control retained the less issues are likely to arise as time goes on. From the franchisees perspective, the more freedom secured, the less rules he/she needs to live by. While there is...

RULES FOR SUCCESSFUL FRANCHISING

Tudog has been focusing a bit on franchising because it has determined that using the franchising platform as a driver for expansion and growth matches the objectives, resources and opportunities of a number of clients. In most cases these clients have not even considered the franchising option because they associate with...

PRICING FRANCHISES

Pricing is always a tricky process. A company never likes to under price what it is selling because it is leaving money that could be in its coffers behind. The urge is to price high and see how the market reacts. Unfortunately, this is not a viable approach because the market will almost certainly react negatively if what you are selling is deemed not worth what you are selling it for. Therefore, the challenge is to estimate the value your buyers most likely will assign to your product/service, compare yourself to other players in the market, and set the highest price possible.



DULY QUOTED

"Wisdom too often never comes so one ought not to reject it merely because it comes late".

- Felix Frankfurter

WISH WE SAID IT

"It is always the adventurous who accomplish great things".

- Charles de Montesquieu

THOUGHT OF THE MONTH

Starting Over...Again

Once again we find ourselves at the inauguration of a new year, bringing with it the opportunities new beginnings offer. For many of us the opportunities will go the way of our New Year resolutions – approached with goodwill but little enthusiasm. They will fail to come to fruition because we will not give them the dedication and support it needs to flourish.

It occurs to us that the reason we make promises to ourselves on New Year's – as opposed to whenever the need for the promise arises – is because we need the power of the "fresh start" to get us committed. Then, of course, for many of us, the magic of the New Year fades and we are back to our old ways. Our inability to truly commit and nurture the resolution indicates that it never really was that important to us. We believe this because we believe that we all have the capacity to accomplish our goals when they really and truly mean a great deal to us.

Like resolutions, opportunities need to be nurtured. They need to be given the chance to thrive by being afforded all the resources and energy they require. Without a true effort, opportunities fade away and are most often lost beyond recovery. It's like the children's adage; "while you're deciding whether or not to get your net, the butterfly is flying away".

The New Year marks the fresh start many of us need to revisit the unfinished business of the previous year and, while reconciling the objectives with the accomplishments, set the path we need to move forward. Certainly some of our plans will include unfinished business from the previous year, and other portions will set the stage for a new series of goals.

The important point is that we accept the new beginning as the onset of new possibilities and we endeavor to discovery and embrace the opportunities that the fresh outlook brings. Our ability to remain committed is what will separate the successful from the mediocre, an assessment we are all certain to make as this year winds to its end in December. For us, our commitment is to be on the side of the successful. We look forward to seeing you beside us.





KNOWING WHEN FRANCHISING IS RIGHT

By Craig R. Frank

Last month this space was used to make the case for franchising. The options for companies seeking to expand can include organic growth and developing an affiliates network. Franchising is not the sole possibility, but it has distinctive advantages that, if leveraged properly, can serve to accelerate the pace of growth and establish a commanding competitive advantage.

Franchising is not a new concept. According to research conducted by Tudog, some academics believe that franchising was first used, albeit in a primitive way, in the Middle Ages as landowners sold the right to collect taxes to others. The real boom in franchising occurred in the 1950s and 1960s when the companies we are all now so aware of, such as McDonald's, Carvel, Burger King and others, got their start.

Like every strategy, franchising is not without its faults and risks. While these need to be fully understood and considered when weighing the franchise option, the conditions shared herein will serve as the primary motivating factor in exploring franchising. Moreover, franchising may be right as a strategy, but unsuitable for your particular industry or sector. Determining whether franchising is right depends on how well your company meets the following critical points:

- 1. Operations are Labor Intensive** – because the owner of a franchise is also the operator and has an invested interest in the performance of the enterprise, the more labor intensive (as opposed to capital intensive) the work is, the better it suits the franchise model. The work will get done because the franchisee has a vested interest in making sure it does.
- 2. Outlets are Low Cost** – the requirement that the franchisee pay the costs of preparing and opening the outlet means that very costly units will minimize the number of potentially available franchisees that would have an interest in your company. The lower cost units have a better chance of success because the number of prospective interested parties from which viable franchisees can be selected is much larger.
- 3. Local Market Knowledge is Helpful** – not every business needs adjusting according to local market habits, but those that do are well suited for franchising because the local franchisee is seen as having that local know-how and network needed to boost the

business. Add to this the previously discussed inclination of franchisees to have the proper owner perspective and motivation, local standing makes franchising a viable option.

4. Brand Name is Important – if you are in an industry where brand name has no bearing or influence on the decision of the customer/client then franchising may not be the best strategy to pursue. Brand is a central component of franchising, with franchisees primarily attracted to the strength (or potential strength) of your brand. If you are in a sector where brand can make a difference and serve as a sales driver, franchising is worth looking into as an expansion option.

5. Your Business can be Standardized – the only way you will be able to successfully franchise is if you are able to standardize your operations so that there can be a replicable result each time your process is engaged. This means that you have to be able to ensure that you produce the same results each time and that these same results can be achieved regardless of which franchisee is engaging the process. If you are unable to standardize the operations or if the results are somehow reliant on expertise or know-how you are unable to transfer (via training and support) to the franchisee, you may not be able to franchise. The standardization of product is what makes franchises successful because it allows for consumers to understand, anticipate, and expect certain results when they engage the company.

6. Local Production is Possible – one of the key advantages to franchising is that, with the proper training and support, the franchisee is responsible for the recruitment of customers/clients and the delivery of products/services. If your product or service cannot be fulfilled on the local level, one of the primary benefits of franchising could be lost. There are some franchises that fulfill at a central location and then distribute the product or service to the franchised outlet. These models do work depending on the type of product/service the company sells. However, even in these models, there is an additional layer of activity or expense that cuts down on profitability and makes the franchise model, for these circumstances, suspect.

7. Local Management Needs to Make Decisions – if your company is such that all decisions are made – or need to be made – at the top level then franchising is not for you. What franchising does better than most other multi-unit expansion models, is create a strong independent presence at the local level. The franchisee, as an independent manager, has all the incentives necessary – including an investment of capital and a lion's share of the profits – to make good decisions. With your training and support these decisions can be improved and the probability of the right decision increased. Franchising allows for the establishment of strong local management that has all the right reasons to make the best decision. If your company model calls for or has the need for strong local management, then franchising could be the way to achieve this.

Franchising is not an effective model for every business. However, if your company meets the 7 aspects discussed above, there is the possibility that franchising makes a lot of sense and could prove to be a cost effective way to significant and rapidly expand the size and revenues of your company.

Craig Frank is Tudog's CEO.



THE DISADVANTAGES OF FRANCHISING

By David Gilad

The hype surrounding franchising can be so seductive that it causes executives considering the option to abandon all semblance of logical evaluation for the promised glory and increased profits. Attending a franchising seminar is like a cheerleading talent show, with presenters offering up frenzied accounts of wild success while asking inane questions about the audience's interest in success. All of this serves to obstruct the view to one huge wall of doubt that should at least initially cast on any decision to franchise.

There is no doubt that under the right circumstances franchising is an excellent strategy that makes a great deal of sense and should be pursued aggressively. Under these situations the downside of franchising is well outweighed by the advantages. It is these advantages that are getting all the attention, while the disadvantages are somehow swept under the rug for people to discover through their own investigation – or worse their own experience.

Tudog doesn't work that way. We believe that every possible disadvantage needs to be known and understood before a strategy is selected. The attractiveness of advantages notwithstanding, it is the disadvantages that cause the problems and can turn a potentially successful venture into a resounding failure.

Therefore, the recent discussion in these pages on franchising and the value it can bring to an enterprise is hereby offset, or at least put into perspective, with this discussion of the very real and potentially disastrous disadvantages of franchising.

1. **Goal Conflict** – franchising causes a natural conflict of interests between franchisor and franchisee, stemming from the way each makes money. The franchisee makes money by deploying the franchise system and serving customers – from which payment is extracted. This means that the franchisee wants to serve as many customers as possible using the franchise system, which in turn means that they want as few others as possible using the franchise system in or around the area from which they hope to attract and serve customers. On the other hand, the franchisor makes money by selling as many franchises as possible, even if that means that the average revenue of each

franchised unit goes down. So the franchisor may, and often does, sell multiple franchise units in areas where fewer units would mean more sales per unit. This cuts down on the money each franchisee makes, causing conflict – and often leading to litigation – between franchisee and franchisor.

2. Inherent Disincentives – the franchise system has inherent disincentives built into its structure. The nature of the system does not necessarily encourage individual franchisees to adhere to every aspect of the franchisor's system, particularly those parts of the system that cost him/her money but bring very little return. While there are guidelines set out in the Franchise Agreement that requires adherence to most aspects of the franchisor's operations, some elements cannot be defined and others cannot be controlled. These are the elements that the franchisee, not out of malice but rather out of an attempt to make as much money as possible, will ignore or pay less attention to. The more franchise units you have in your area, the more likely this is going to occur. For example, a franchisee might not market as aggressively as he/she ordinarily would if there are other local franchisees doing marketing. The franchisee might, probably correctly, conclude that the brand is getting exposure and he/she will get increased traffic based on the activities (and dollars) of others. So, rather than add to the momentum and market as well, he/she actually has an incentive to do nothing and enjoy the benefit derived from the actions and money of others.

3. Difficult Environment for Innovations and Change – the franchisee is often uninterested and unwilling to participate in franchisor initiatives because they do not always serve his/her interests. It is because of this that the all too familiar “available at participating locations” has come into our lexicon. The franchisees who elect not to participate have concluded that the discount the program requires they offer does not make sense for their particular unit, even though it may make sense for the chain. Similarly, when a franchisor wishes to introduce a new product there might be franchisees who decline because of the new equipment that might be required or the new inventory that might need to be carried. The inability of the franchisor to require participation severely weakens the franchise model and opens up for inconsistencies in the marketplace.

4. Lower Financial Returns – while franchising is a cheaper and accelerated way to open up many outlets, it is not necessarily the most profitable way. It is necessary to keep in mind that the trade-off for not having to spend any money to open the unit (and in fact getting paid by someone else for the right to do so) is that at best you will see approximately 4% - 10% of the gross revenue. In businesses that carry 20% or higher gross profit rates, settling for 4% - 10% is quite a reduction.

Franchising establishes a business relationship between two independent companies – the franchisor and the franchisee. This by definition creates two distinctive sets of interests, which by definition creates the opportunity for disagreement and issues. While franchising may still be the best alternative for your company to expand and grow rapidly, knowing these disadvantages can at least make sure you're not caught by surprise.

David Gilad serves on Tudog's Board of Directors



KEY FRANCHISING POLICIES

By Ofer Kahane

The most critical aspect of franchising is not the sale of the franchise units but rather the policies the franchisor incorporates into the Franchise Agreement. These policies will dictate how the franchisees operate, what they are allowed and not allowed to do, and what obligations are placed on each party. From the franchisor's perspective, the more control retained the less issues are likely to arise as time goes on. From the franchisees' perspective, the more freedom secured, the less rules he/she needs to live by. While there is validity to both sides, the fact is that for the franchise operation to succeed the interests of the franchisor need to be primary. This article is about the policies the franchisor needs to consider.

The Franchise Agreement is a broad legal document that seeks to foresee any and all scenarios under which the two separate legal entities that are the franchisor and the franchisee might interact. The Agreement seeks to define the relationship and regulate the activities of all sides, so that the business of the franchisor and the business of the franchisee will, while being mutually exclusive, succeed in operating side by side and one with the other.

From Tudog's perspective, while there are many scenarios and many aspects to the agreement that need review and careful consideration, there are really 4 specific areas that require policymaking and can differ depending on the policies the franchisor seeks to pursue and enforce. These policy areas are; (a) ownership of franchises, (b) franchisee compliance, (c) term of the agreement, and (d) marketing.

Covering these four areas will enable you to bring to your lawyers the foundation and parameters within which you want the Franchise Agreement to be constructed. Understanding the four areas is therefore critical:

Ownership of Franchises

The key issue with franchise ownership is whether or not you will require the franchisee to also be the operator of the business. While this may seem logical, it really depends on the kind of business you are franchising and whether the franchisee's full time attention is required, as opposed to that of his/her dedicated staff trained by you.

Perhaps against logic, more than 75% of all franchisors do not require the franchisee to be the operator. The reason is primarily because most companies want to be able to have multi-unit franchisees and the operator requirement would disable this option. The studies however indicate that non-operator franchise units perform significantly lower than owner/operator units because the owner/operator has all the proper incentives to perform to maximum capacity.

Deciding whether to allow passive ownership is a question you need to address not from the multi-unit perspective, but from the performance per unit approach. If you are willing to have some units under-perform so that you can, in exchange, sell more units via multi-unit agreements, then passive ownership is the right way to go. If, on the other hand, you want to maximize the performance of each unit, you need to require owner operation.

Franchisee Compliance

The structure of franchising – governed by an agreement between two separate business entities – requires that the franchisor take a number of vital steps to ensure that the agreement reached is kept. It is important to recognize that franchisee non-compliance can have tremendous effects on the franchisor, as misbehavior or failure to meet market promises can erode the brand, scare off new franchisees, and affect revenues. Conversely, franchisors that go too far in regulating franchisee behavior can breed resentment, inhibit franchisee activity and growth, and chase away prospective franchisees not interested in working under such tight restrictions.

So the question is, how do you balance your need to ensure franchisee compliance with the equal need of being attractive to franchisees? The answer is by understanding what aspects of operations are essential to control and which ones offer the opportunity for some flexibility. The areas that demand strict structure are:

- The enforceability of the agreement – you need to make sure you will be able to demand and compel compliance for every clause in the agreement. Having clauses that you cannot or will not enforce dilutes the strength of the agreement and could lead to franchisees testing your resolve.
- Termination rights – you need to make sure you have a legal means of terminating the franchise relationship if the franchisee proves to be unable or unwilling to comply with the terms of the agreement. While the reasons for termination need to be reserved for extreme conditions, the right to terminate needs to be preserved.
- Controlling quality – you need to keep in mind that the quality of the product/service being delivered by or via the franchisee is a reflection of your company. You need to make certain you have reserved the ability to control quality whether through the provision or approval of designated suppliers or through quality control mechanisms.
- Ensuring royalty payment – the primary source of sustained revenue for your company will be franchisee royalty payments. The need to secure timely, accurate payments is essential to the financial health of your company. You need to make certain that your agreement spells out the methods for calculating royalties, your rights to audit to ensure proper payment, the schedule for royalty payments, and the assigned late fees for payments not paid on time.

Term of Agreement

The term of the agreement is a critical issue because it determines the length of your association with the separate legal entity that will own and operate a franchise of your company. The initial term – typically 10 or 15 years – is usually supplemented with an additional 10 or 15 year renewable term.

There are two sides to this matter. First, you want to make sure that your term is sufficient for the franchisee to feel your franchise is a value. For example, a term that is too short could lead prospective franchisees to fear that they are buying something that will expire before its true value can be realized. A term that is too long can serve to intimidate prospective franchisees who may see the commitment as too great an undertaking.

Another thought to keep in mind is that in many circumstances a franchisee elects not to renew a franchise because he/she feels that the ongoing royalties are not justified in light of their ability to proceed without the franchise brand. For example, an ice cream store franchise operator that has been on the same corner for 15 years may feel that he/she has the customer base and market presence necessary to give up the brand and move to his/her own name. For this reason, you may want to include a renewal clause that requires conditions for non-renewal.

Marketing

The policies you adopt with regard to your marketing are critical to the success of your franchise. Firstly, your marketing has two primary objectives – to raise awareness and create interest in prospective franchisees, and to do the same in the markets you are targeting for your products/services. As relates to your franchisees, only the latter is important and you must create policies that demonstrate to the franchisee that your marketing will serve as a way to drive business to their franchised unit.

Your marketing needs to aim toward the creation and maintenance of your brand and the ongoing establishment of new interest in your products and services. The decision to advertise nationally or regionally is a function of where you currently have franchisees and which areas you expect to expand your franchise base. In addition you need to provide your franchisees with the capacity and guidelines within which they will engage in local marketing.

In almost every case the franchisor requires the franchisee to pay an additional percentage of gross revenue (above the royalty fee) of between 2% and 3% for the purpose of supporting marketing activities to be led by the franchisor. In addition, many agreements call for franchisees to spend an additional sum (often also 2%-3% of gross revenue) on local marketing. In these situations, the franchisor usually leads the way with prepared marketing materials for the franchisees to use.

The development of strong policies in the 4 major areas that call for well conceived policy decisions is the best way to make certain that you have laid the groundwork for a stable, predictable, and reliable franchising operating.

Ofer Kahane works with Tudog in Israel.



RULES FOR SUCCESSFUL FRANCHISING

By Ilan Sarid

Tudog has been focusing a bit on franchising because it has determined that using the franchising platform as a driver for expansion and growth matches the objectives, resources and opportunities of a number of clients. In most cases these clients have not even considered the franchising option because they associate with fast food and other relatively low-end concepts. Tudog has discovered that this is not true, and while some “personality” of the business needs to be sacrificed on behalf of the standardization that is required in order to succeed at franchising, chances are you have to compromise on that personality regardless of the growth strategy you select. This being the case, there are instances when it makes great sense to look closely at the franchise model.

Still, not every concept is suitable for franchising. If you try to force the model you will discover that either there is no interest in your franchise, or you are unable to sustain the model, leading to franchisees failing and most likely a series of lawsuits. Franchising, like every other strategy, has the boundaries within which it can and will succeed. Tudog has identified 9 elements of the franchise boundaries. They are:

Tudog has been focusing a bit on franchising because it has determined that using the franchising platform as a driver for expansion and growth matches the objectives, resources and opportunities of a number of clients. In most cases these clients have not even considered the franchising option because they associate with fast food and other relatively low-end concepts. Tudog has discovered that this is not true, and while some “personality” of the business needs to be sacrificed on behalf of the standardization that is required in order to succeed at franchising, chances are you have to compromise on that personality regardless of the growth strategy you select. This being the case, there are instances when it makes great sense to look closely at the franchise model.

Still, not every concept is suitable for franchising. If you try to force the model you will discover that either there is no interest in your franchise, or you are unable to sustain the model, leading to franchisees failing and most likely a series of lawsuits. Franchising, like every other strategy, has the boundaries within which it can and will succeed. Tudog has identified 9 elements of the franchise boundaries. They are:

1. Make Sure Your Industry is Right – there are certain industries that are not suited for franchising primarily because the level of expertise required to operate the business is not typically possessed by the average person and cannot be taught to them in a

timely and cost effective way. Under these circumstances you could in fact franchise if you elected to, but your field of potential franchisees would most likely be too small to justify the costs associated with developing the operational and legal structures of a franchisor.

2. Know What You're getting Into – franchising is an ongoing process that requires you support and maintain your franchisees. You must make certain before you embark on the franchise path that you have done a complete analysis of the advantages and disadvantages associated with the model and that you have concluded not only that the pros outweigh the cons, but also that you are able to deliver and sustain delivery of your product development, training and service obligations. You also need to make certain you have the infrastructure in place to work with franchisees as well as monitor their compliance to the franchise agreement.

3. Establish Strong Policies – the running of a franchise business is not necessarily easier than operating multiple company owned units. The idea behind franchising is that the franchisee serves as an excellent local manager because he/she has paid a fee to get into the system and therefore has the motivation to succeed. The downside is that sometimes that success may come at the expense of the franchisor or the brand. Therefore policies associated with franchisee interaction, operations, marketing and other critical issues need to be established, institutionalized into your operations, monitored and adjusted as necessary, and maintained for operational integrity and profitability.

4. Commit to Your Franchisees – the franchises that fail are those that adopted the strategy because they were attracted to the initial fee franchisees pay to enter the system. This fee is generally no more than a way for the company to recover the expenses it put out in order to establish the franchise's legal and operational infrastructures, create the standardized processes, and train the franchisees. There is not much profit in the initial fee unless you are a veteran franchise operation that has already recovered initial expenses or you have succeeded in selling so many units that you have managed to cross over to profitability after retrieving initial costs. Either way, however, the reason for selecting the franchise model is not the initial fee, but rather the low costs of expansion, the development and value increase in the brand, and the ongoing royalty payment. These three reasons cannot and will not be fully realized if you do not, from the very start, commit yourself to the success of your franchisees and do everything in your power so that they flourish.

5. Understand Your Expansion Strategy – one of the key issues with franchising is the placement of franchise units in terms of proximity to existing franchises. If you place them too close to one another you will provoke franchisee dissatisfaction, and perhaps even legal action. If you place them too far apart from one another you might not be meeting the demands of your customers or maximizing the potential of your business. The expansion strategy needs to balance these two contrasting objectives and make sure that you are approaching the U.S. in a logic sequence and that you are dividing up territories in a reasonable way.

6. Select the Right Price for Entry – the price of entry into your franchise system is a function of the overall cost of the build out and execution of your concept, the extent and intensiveness of your training, the degree to which what you offer cannot be easily duplicated (protected by trademark or with a high degree of market awareness), and the

capability of your targeted franchisees to bear the cost you're demanding. As with any pricing strategy, your desire to maximize your profits needs to be balanced by the value you are providing and the ability of your market to pay. You should not be looking at the price of entry as a profit center, but rather as a means of recouping the investment you have made in training programs and codifying your operations. Your profit expectations should be focused on royalty payments. This will help you keep your price of entry reasonable and your service levels to your franchisees high.

7. Support Your Franchisees – franchising is all about the franchisees. A company that fails to support its franchisees will soon find itself in a world of trouble as the level of sales will decline, franchisee cooperation will erode, and your customers will begin seeking alternative outlets for their needs and wants. The provision of support to franchisees is an act of enlightened self-interest because the better the franchisees do, the better the company does both in the sense of the royalties received and in the sense that it will be easier to attract additional franchisees. Supporting your franchisees means providing them with the training they need to properly operate your business, as well as creating the mechanisms for on-going assistance when they feel they need some guidance. There may be costs associated with a high level of franchisee service, but you will find it is well worth the expense.

8. Distribute Franchisees Wisely – not only do you need to make sure that you properly define the structure and criteria for what constitutes a franchise territory, you must also make sure that you have the criteria set for the type of person you believe will make a successful franchisee. Again, if all you are trying to do is sell franchises so you can get the initial fee, you will soon find your business ailing. You need to make sure that your franchisee is suited for the type of business you have, that they are the type of person that follows rules and instructions, that they have a genuine interest in what you are doing, and that they have the basic (pre-training) skills needed to succeed.

9. Stay Legal – keep in mind that franchising is a regulated system and that there are rules and laws that need to be followed and processes that need to be adhered to in order to be compliant with all the requirements. Creeping close to the edge of the rules may help you sell a few extra franchises or extract a few extra dollars, but in the end the complications brought on by FTC investigations and perhaps sanctions negate any benefits you may have enjoyed.

Succeeding in franchising is very much like success in other forms of business. If you act with forethought, plan well, execute properly, and aim to deliver a true benefit, chances are you'll go very well.

Ilan Sarid specializes in sales. He resides in Montreal, Canada



PRICING FRANCHISES

By David Feingersch

Pricing is always a tricky process. A company never likes to under price what it is selling because it is leaving money that could be in its coffers behind. The urge is to price high and see how the market reacts. Unfortunately, this is not a viable approach because the market will almost certainly react negatively if what you are selling is deemed not worth what you are selling it for. Therefore, the challenge is to estimate the value your buyers most likely will assign to your product/service, compare yourself to other players in the market, and set the highest price possible.

Naturally there are times when a company intentionally opts to sell at a lower price. Insofar as this article is not a discussion of pricing per se, but rather the pricing of franchisees, the discussion of value pricing is not applicable. In almost all cases, the pricing of a franchise seeks to maximize revenues, and not appeal to a wide range of buyers.

Pricing issues for a franchise have two components. They are:

- Pricing of the franchise fee or the initial sum of money the franchisee must pay in order to purchase the franchise, receive the training, and gain the right to operate the franchise.
- Pricing of the royalty the franchisees pay on an on-going basis as part of the franchise agreement. The royalty is typically a set percentage of the revenues.

Franchise Fee

Beyond our discussion of pricing as a function of market tolerance and competitive necessity, the factors to consider when placing a price on your franchise fee are:

- The value of your brand name – the more your name is well known and well respected, the greater the value and the higher you can charge
- The number of franchisees – as your system grows and you have a large number of franchisees you can increase your price as the demand for the units can be considered greater
- The profits of operating units – if your units are highly profitable and you are able to demonstrate that through existing units, you can charge more because you will be able to show the return on investment.

- The degree of training – if you provide a high degree of training and on-going support you may be able to command a small premium as prospective franchisees may see added value in your guidance.
- Additional costs – some franchises have low franchise fees but require a great deal of capital to get the business up and running. You need to measure the total cost (franchise fee plus necessary capital) when determining your franchise fee so that the total cost is not more than you typical target franchisee can afford.
- Competition – as with all pricing, you need to take a look at your competitor's pricing and how that policy is affecting sales. If you are offering more service, a better system, a higher profile brand, etc. you can charge more. If your competitor has an established name and a longer time in the market, you may want to charge a bit less.

Royalty Fee

When determining your royalty rate you need to be aware of two very critical points:

- The royalty rate is your primary source of revenue and makes up more than 90% of the money you will receive from franchisees over the course of your business.
- The royalty rate comes off the revenues and not the net profit, meaning that you need to be certain to leave enough in the business for the franchisee to extract from it what he/she needs to make the proposition worthwhile.

These points raised, arriving at a royalty fee takes into consideration the following:

- The nature of your industry – certain industries have more or less set percentages for royalties. Since royalties are on-going it is difficult to create the perception of value necessary to justify a markedly higher percentage than the industry norm. Therefore, if you are in an industry where many of your competitors are already franchising and they all see to be requiring the same royalty, chances are you will be boxed into this rate as well.
- The operating margins of your business – you need to keep in mind that your royalties are an operating expense for your franchisees that comes off of the top, so if your operating margins are relatively low, you will be unable to command a high royalty rate because the franchisees will simply be unable to sustain operations.
- The need for support – some businesses are completely cookie-cutter and can be duplicated with very little on-going support. These sorts of businesses can get away with a low royalty rate because their corresponding expenses will be relatively low. On the other hand, businesses that require a great deal of continuous support may need to demand a higher fee in order to offset the costs associated with delivering service and support.
- The need for development – some businesses require constant R&D and the introduction of new products and services. Insofar as these innovations are the task of the franchisor, you will need to make certain that your royalty revenue is sufficient to support the new developments you need to regularly introduce.

Franchise pricing is a tricky business because the standard guidelines for pricing and the traditional pricing strategies are rendered inappropriate by the demands of the model. The franchising model calls for dual pricing and, when best practiced, an association between them. It would seem odd that a low franchise fee would come together with a

high royalty fee, because it would indicate that most likely one of the two price points were out of sync. The best policy is to price your franchise in such a way that people will want to buy them and be able to make a living running them, and that you, at the same time, can gain financial benefit and reward. If you are able to do this, you have the definition of the classic win-win scenario.

David Feingersch works with Tudog in Florida.