



TenStep Supplemental Paper

6 January 2004

Revenues from Franchising

A franchise is a form of business ownership wherein a company grants to a buyer the right to sell or distribute its products or services under a prescribed format in exchange for royalties or profit-share. A successful entrepreneur with a novel idea or concept can become a franchiser and enter into a franchise agreement. Such an entrepreneur can generate revenues from the following sources:

- **The initial franchise fee.** This is a single payment by the buyer to acquire the franchise rights. For this fee, the franchiser provides a pre-packaged business plan that includes start-up procedures, vendor contracts, and guidelines for operations. The fee could cover assistance in site selection, accounting & control systems, and on-site consultations with company personnel.
- **Royalties.** Among the various ways to structure royalty payments, the most common is a percentage of gross sales that depends on sales margins. The royalty charges depend on the support extended by the entrepreneur. Some franchise agreements replace royalty with percentage split in gross profits; others specify fixed payments based on sales volume.
- **Products & supplies provided.** Franchisers become vendors for their franchise owners. While individual owners are not always required to buy materials and supplies from the franchiser, they normally do so. Franchisers can buy in bulk, distribute efficiently, and guarantee quality.
- **Services to franchisees.** For a retainer or periodic fee, franchisers can provide a range of services. These include accounting services, purchasing contracts, market research, payroll accounting, assistance with credit, and technical advice.
- **Promotional fee.** Normally, national promotion and advertising fees are specified in the franchise agreement, usually based on gross revenue.
- **Real estate income.** Where franchise outlets require unique physical facilities, the franchiser provides them. By doing so, the franchiser controls store renovations and fixtures.

A good franchise agreement should benefit both parties; the endeavors should be cooperative, where both parties are committed to long-term success.