

funding a SERVICE FRANCHISE



SERVICE FRANCHISES PRESENT SOME UNIQUE CHALLENGES WITH REGARD TO FUNDING. DANIEL CLOETE FROM WESTPAC LOOKS AT SOME OF THE ISSUES

⇒ Service and business-to-business franchises are very popular with franchise buyers at the moment. So what is a service franchise and what are the benefits and drawbacks of owning one? Also, if you don't have significant assets of your own, how do you go about funding the purchase of such a franchise?

WHAT IS A SERVICE FRANCHISE?

Service franchises operate in a vast variety of industries. There are opportunities covering a wide range of occupations and skill levels as well as investment levels. Examples of service franchises include: business coaches; bookkeeping; real estate agents; travel agents; handymen; pool services, lawn mowing and garden services; commercial and domestic cleaning; taxis, automotive services; education and childcare; mortgage brokers; computer services; transport and courier services; appearance medicine specialists and many others.

From this brief list, you can see that most people would be able to find a service franchise that suits their skill level, interests, risk profile and investment ability.

POTENTIAL BENEFITS

• Service franchises tend to offer a relatively high return on investment compared to industries such as retail or manufacturing. For example,

establishing a mobile pool cleaning business may cost \$60k versus \$400k for a retail swimming pool shop yet still offer a good income to the owner.

- Many service franchises are relatively low risk.
- Some offer a guaranteed income or a work guarantee for a limited time (with conditions attached).
- There is a wide variety of service franchises available in many industries.
- Despite the recession, there is high demand for many services in a modern economy. In fact, some companies are outsourcing more these days rather than keep non-essential services in house.
- Service franchises offer a good way of using your skills rather than capital to get into business.
- They usually require less capital, making them more affordable.
- The overheads in many service franchises are low; eg, mobile services do not need expensive premises and many business advisors work from home. This means they tend to return a positive cashflow quite quickly.
- You are not restricted by having to work retail hours. This means you may be able to enjoy flexible hours to suit your lifestyle (however, bear in mind that shorter hours may directly impact your income).

- Service franchises tend to require more direct input from the owner than a typical retail operation.

POTENTIAL DRAWBACKS

- While returns on investment are high, many service businesses may offer low absolute profits.
- Earnings may be limited by the hours that can be physically worked by the franchisee or by the franchisee's own abilities.
- Risk can be higher, especially in businesses that require skills such as excellent selling ability or in marginal or new industries.
- It could be difficult to grow the business beyond a certain size because franchisees are not allowed to employ others, the area may be limited, or the owner can only do a finite amount of work.
- Many service businesses require a lot of selling, which doesn't suit everyone.
- The small size of some service businesses in itself increases the perceived risk to others, making it difficult to fund or sell.
- A high level of skills may be required in some franchises: for example, plumbers or business advisors may require qualifications or experience.
- The business tends to be very dependent on the owner and/or key employees. This can present significant risk in the case of illness or staff departures: eg, a real estate agency where the star seller leaves and takes their clients with them.
- There are of course a number of other advantages and disadvantages and a good business advisor (specialist franchise accountant, lawyer and banker) will be able to point those out for any specific opportunity.

FUNDING TO BUY A SERVICE FRANCHISE

Some of the characteristics of service franchises mentioned above can make it more difficult for banks to fund service franchises. Although return on investment may be good, making it possible to earn \$150k per annum from a \$100k investment as opposed to the \$450k that might be required for a retail operation, there are few assets, stock or fit-out for a bank to fund against. In addition, the perceived risk to the bank is higher because it depends to a large extent on the skills of the franchisee. In many cases the generally lower capital requirements of service franchises mean that prospective purchasers are able to provide security for loans in the form of equity in property or other assets. What happens, though, if you want to buy one of the higher investment level service franchises or a highly profitable existing business with a lot of goodwill but little in the form of assets?

This is where it pays to deal with specialist franchise bankers with a real understanding of the cashflow and the value of the intellectual property and systems of the specific business. When seeking funding, having excellent information and a good understanding of the business model are vital, and a banker who has good knowledge of the franchise can not only help address the funding needs but can also add to your understanding of the business.

The other important aspect here, as we have seen, is the intending franchisee's own skills and abilities. Because these are crucial to the success of the business, when you approach the bank for funding it is important to have a CV or summary of your experience. This can help the bank to evaluate risk and improve the likelihood of your receiving the funds you seek. Once again, the more familiar the banker is with your chosen franchise and its other franchisees, the better they can help you.

SUMMARY

- The services sectors of franchising offer a wide range of exciting opportunities with relatively low investment and high returns.
- Although not without risk, these are sectors where people can use their time and skills to have a secure and profitable future.
- While the lack of actual assets can cause some funding issues, these are best resolved with the assistance of a specialist franchise banker. ■

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The information contained in this article is intended as a guide only and is not intended as an exhaustive list of matters to be considered. Persons entering into franchise agreements should seek their own professional legal, accounting and other advice.