



Understanding Franchise Fees and the costs behind them

By the Franchise Brokers Association



What is the cost of a product?

It is normal for consumers to underestimate the cost associated with delivering a product or service. It makes sense. How would they know those costs if they are not in the business of producing the products or services? The average consumer does not have that level of insight or clarity around the cost.

For example, a shopper may purchase a \$10 t-shirt and be told by an associate, “that t-shirt only costs \$1 to make.” The average shopper may be surprised by the markup of the t-shirt.

Let’s look at the costs and complexity that went into making it. Here’s a short list of what went into the making of that \$10 shirt.

1. The idea for the business had to be created
2. The business had to be organized, incorporated, and launched.
3. The owner had to get funding for the business
4. The owner needed to have the passion and motivation to move the business forward in the face of challenges.
5. A place to work needed to be established.
6. The designers had to design the shirts.
7. Testing and review of the designs for consumer response and salability had to be assessed.
8. They had to source suppliers.
9. They had to go through the legal and due diligence process of securing those suppliers.
10. They had to source manufacturers.
11. They had to go through the legal and due diligence process of securing those manufacturers.
12. They had to figure out how to transport the product from the manufacturer to the stores.
13. They had to have salespeople secure the distribution channels with storefronts.
14. Once they got the store secured, they had to market to get people to go to the store to get the shirt
15. They had to set up the store’s systems to ensure the inventory is tracked and controlled.
16. They had to ensure the store clerk has the training to promote it and ring it up for the sale.



This is a short list. There are many more steps that were missed in the list but for the explanation, this sample shows there are far more expenses, organization, and high-level work that goes into the production of that \$10 shirt. Those additional costs for the production must be factored into the total price of the product to maintain profitability.

Franchise fees by type

How does this example relate to franchise fees? Franchise fees are the same way. They include items that are clear to see and a whole lot of items that are *not* easy to see. Let's break down what goes into each of these fees so you can have a bit more perspective on why they are there, what they pay for, and what you get from them.

There are four main fee types. We will go into detail on typically covered expenses for each.

1. Initial fee
2. Royalty fee
3. Advertising fees
4. Technology fees

Depending on the franchise, there could be more fees, but these are the main four that are consistent across most franchise brands.

This paper is designed to put the costs associated with a franchise in perspective and to analyze the cost of replicating similar services.

The Initial Fee

The initial fee is also called the franchise fee. The national average franchise fee was \$42,000 as of the beginning of 2022 (according to Vettedbiz and their review of 3,000 franchises).

The initial fee pays for many things. To name a few, the marketing to find quality new owners, the development team to qualify and educate those buyers and help them transition to owners of the franchise, the initial training, the launching support team costs, and ongoing support costs (until the franchise starts producing enough revenue to cover the support costs associated with the license), and the knowledge and insight of the systems and processes that created the success of the franchise.



A franchise system should be a **proven system**. Otherwise, they are franchising an idea.

To have a proven system - the franchise (or Franchisor) has to do quite a bit to build and maintain the systems infrastructure. Each piece of infrastructure must be tested and refined to “prove out” the model.

Here’s a snapshot of what it takes to get a franchise ready for new owners to purchase the licenses and join the system.

1. The idea for the business had to be created
2. The business had to be organized, incorporated, and launched
3. The owner had to arrange to fund the business.
4. The owner has to have the passion and motivation to move the business forward in the face of challenges.
5. A place to work needed to be established.
6. They had to source suppliers.
7. They had to go through the legal & due diligence process of securing suppliers.
8. They had to advertise and interview employees.
9. They had to hire employees and go through HR processes.
10. Develop the employee training.
11. Conduct the training for employees
12. They had to have salespeople selling the products or services
13. Build the performance tracking systems and tools
14. Test the systems
15. Get adoption from employees of constant new systems and system changes during the testing phase
16. Track performance and tweak the results
17. Build all the marketing materials - copy, design, and photography.
18. Build the websites.
19. Research the marketing channel options.
20. Set up the contracts and start the marketing channels
21. Test marketing channels
22. Build the employee management system
23. Design the cultural values of the company
24. Test the values
25. Test employee management systems
26. Focus attention on the employees to adopt the culture and embrace it
27. Repeat all steps above per corporate location or unit they have enough success to become a franchise



Once successfully operating several locations

27. Research attorneys and development companies for the Franchise Disclosure Document and launch the brand
28. Hire an attorney to create an FDD
29. Get a financial audit
30. Build the marketing systems to advertise the franchise license opportunity - this is difficult as the cost to find 1) the right buyer 2) in a higher income range 3) who is interested in franchise ownership at that time - is tens of thousands of dollars
31. Build custom technology solutions
32. Figure out how to benchmark the results of the company for the franchise and the unit owners
33. Build the KPIs (key performance indicators) for the franchise and the unit owners
34. Design the franchise owner support team
35. Design the management for the franchise owner support team
36. Build the training for franchise owner support team
37. Interview
38. Hire
39. Train the franchise owner support team
40. Recruit in a highly competitive market for Franchise Development staff
41. Hire very expensive professional development staff
42. Train the franchise development team
43. Build the franchise sales and award process
44. Start bringing potential buyers into it
45. Manage the franchise research and discovery process
46. Go through the FTC and state legal compliance processes
47. Assess the franchise buyers to ensure they are a good fit.
48. Go through the legal process of signing a new franchise owner
49. Go through the funding process with the new owner
50. Ensure the new franchise owners are being onboarded properly
51. Manage the significant training program (1-8 weeks) and all the support needed to do the introductory launch
53. Manage the first year of coaching, guidance, monitoring, and support while the new owner acclimates to the franchise and launches their business.
54. **Then here is the kicker** - because the 1st year of support is so extensive and the first year is not typically a high revenue production year, the franchise can take significant losses in year one while they are launching the new owner. They pay for support and don't receive equal compensation for those support services deployed.



There is quite a lot that goes into inviting a franchise owner into the system, helping them successfully operate, and get their business fully launched in that first year. The initial fees are in support of all of these items.

The Royalty

The reason you pay a royalty - is for the ongoing support. It's where the franchise and you join in a partnership and say - in this partnership, we win together. The royalty should encompass many services both seen and unseen.

The royalties are the most important fee because they tie your success together. This fee is the one you want. Think of it this way, if you had a partner in a business you didn't pay, how hard would they work for you? Business support with a lack of financial incentive typically fades quickly. For meaningful support, there is a cost.

That royalty investment should make your life easier and your business costs less overall. The franchise can help you make more money and should be worth the expense.

Understanding what is covered by the royalty, is an important thing to know. It creates a more respectful and reciprocal partnership. Here are some items covered in the royalty fees.

1. Maintaining the trademark
2. Working on the brand consistency
3. Growing the brand
4. Developing the training systems for the franchise owner's employees to use
5. Maintaining the culture and growing it
6. Doing the research and development of competitors
7. Testing processes
8. Getting information and maintaining knowledge of laws and the effects of those laws on their franchise owners
9. Getting adoption of systems
10. Getting feedback about system changes
- 11. Problem-solving individual franchise owner issues in the various markets**
12. Connecting owners with each other
13. Running training for owners to improve their knowledge and skills



14. Holding events to bring owners together
15. Going through the legal process of annual licensing and audits
16. Handling disputes with franchise owners and franchise owners' customers
17. Quality checking the system and franchise owners in it.
18. Researching suppliers
19. Negotiating rates with suppliers
20. Getting contracts with suppliers
21. Developing and improving the software and systems
22. Sourcing national accounts
23. Negotiating and securing national accounts
24. Develop lead channels from the corporate office
25. Develop, manage, and run call centers (when applicable)
26. Working on the financials with owners and helping them increase their financial health
27. Strategizing and networking to find new opportunities for owners
28. Developing safety processes and protocols
29. Managing HR information and changes and supporting owners knowing these things

This list is not full. There are so many things the franchise does to grow the unit owner's business (or franchisee). Sometimes the owners don't even realize how complex of an operation the franchise is running - all to help every owner improve daily.

Advertising Fees

When you pay for advertising fees there are usually two fees, national and local.

Local is direct advertising in your area that you would have to pay anyway, it is simply requiring that you invest in the continual growth of the brand in the market. This is an easy one to support because you would be paying that money to market your business. The franchise usually gives a pretty large list of options to advertise with and you usually have quite a bit of freedom here.



National advertising consists of the following items and falls more in the category of the production of the assets to advertise with. Here are some examples and other national advertising costs.

1. Researching suppliers
2. Managing brand reputation
3. Managing social media
4. Creating the imagery for the brand
5. Creating the brand designs
6. Writing the copy for the ads and materials
7. Providing marketing calendars
8. Providing assets for the calendar events and marketing initiatives

Some franchises do advertise with the national fund dollars. In this case, they would purchase in bulk for things such as the following list.

1. Media buying
2. TV advertisements
3. Billboards
4. Landing pages and the pay per clicks associated with the pages
5. Social advertisements
6. Public relations companies
7. Sponsorships
8. Radio advertising
9. Podcast advertising
10. Youtube advertising

The national account fund is used to promote the national presence of the brand and often the chosen advertising investments are decided by a committee of owners who provide insight and direction into the types of advertising they feel would be most effective. Each franchise does this segment a bit differently, so check the Franchise Disclosure Document for a detailed description of the fees and covered expenses with the brand's national marketing initiatives.



Technology Fees

Technology fees are a bit harder to list here because every system is so different. Just know that finding, developing, testing, and perfecting technology is a huge cost. It is extremely painful because there are so many variables, use cases, and incredible complexities that have to all fit together.

There are a lot of systems that claim to be great in technology and then once in the system, you find out all the broken parts of it.

If the system is faulty, the franchise company has to decide to either try and work it out within the current system or go through the difficult task of moving systems. Pulling their data in and out of these systems is not fun. It is usually overwhelming and stressful for the teams and franchise owners as they try to adapt, and learn new systems while finding their footing in them.

It's also very expensive to build and maintain the technology. Think about expensive programmers talking in a programming language. There can often be communication disconnects between what the user wants (the franchise owner and the franchise system) and what the programmers understand. This creates frustration, confusion, and additional costs.

When a good system is found and properly tested, it saves franchise owners time and administrative costs. The benefits of a well-functioning system are enormous. Franchise owners, their employees, and the franchise system all benefit from having organized, streamlined systems that allow for consistent quality operations. Good systems provide that, but they are NOT easy to get to. It takes time, patience, and a lot of capital to build wonderful operational systems.



Summary

The reason there are fees with a franchise is that running a successful franchise is hugely expensive. Franchises are in it for the long game and are holding out for the long-term reward. There is a tremendous investment upfront to build, grow and manage it all. The payoff is much later for most franchises as the system matures and succeeds many times over with each successive owner they develop.

Paying to join a franchise is not an arbitrary license fee. The costs involved are significant to the franchise. Bringing a franchise to market and supporting the franchise owners is a huge and expensive venture.

Ultimately, you pay either way you go - alone or with a franchise. If you go it alone, you are going to pay through painful and long trial and error.

Or if you go with a franchise you are going to pay for other people's knowledge and experience - to make your path easier.

We hope this gives you some perspective on what is actually going on behind the franchise fees.