Financing Your International Development Program

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BY WILLIAM EDWARDS, CFE

WE ARE ALL AWARE of the tight credit situation here in the United States when it comes to franchisee financing. The International Franchise Association has taken the lead with banks and U.S. government agencies to educate them on the value of the proven business systems known as franchises and the impact franchising has on this country as a job creator.

Partly due to the U.S. economy and the tight bank credit, many U.S. franchisors have been focusing on the international development of their brands in recent years. So, how does financing impact international franchise growth? In two ways, first, the U.S. franchisor has to finance the market research, trademark, legal, training, support, travel and marketing costs associated with taking their franchise global. Second, they have to find international area or master franchisees that have access to the capital needed to acquire, build, own, operate and possibly sub-franchise the U.S. brand in other countries.

This article will look at just two of many programs coming available that have the potential to at least partly finance and accelerate the international development of U.S. franchisors and their international franchisees.

Franchisor Financing

The cost of acquiring, training and starting up an international licensee can be high for the U.S. franchisor, often in the range of U.S. $50,000-$200,000 per country depending on the brand.

While most, if not all, of the initial licensee acquiring cost will be paid for by the initial area license or master franchise fee received by the franchisor, this is initially out of pocket and typically does not include localizing the manuals and software required to make the international operations successful. Localization may be paid for by the new licensee. But, in any case, the franchisor has a considerable investment to find, evaluate, sign and start-up the new international franchisees.

U.S. government agencies from the Department of Commerce to the Overseas Private Investment Corporation and the Export-Import Bank of the United States, or Ex-Im, have recently increased their focus on franchising as a significant U.S. export.

U.S. franchisors export American business systems and bring back fees and royalties that help lower our international trade balance of payments deficit. International franchise exports also create good, U.S.-based jobs for people needed to train and support the international franchisees.

After participating in IFA's Small Business Lending Summit earlier this year, Ex-Im conducted a pilot project in collaboration with IFA members Choice Hotels, BrightStar Care, Pollo Tropical, Edwards Global Services and DLA Piper aimed at developing enhanced finance resources for global franchise growth.

Demand for capital-intensive heavy manufactured U.S. exports has in the past significantly outstripped demand for franchise and service-sector financing. But now, recognizing the increasing strength of franchising as an economic driver and U.S. export, Ex-Im will roll out a suite of franchise-oriented products starting at the IFA Annual Convention in February 2013.

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As part of its new focus on franchising, Ex-Im financing will provide franchisor upfront transaction costs, offer a 90 percent guarantee to lenders for export-related working capital lender loans and underwrite transaction-specific or revolving loans. Working capital guarantees will be able to be collateralized by export-related inventory up to 75 percent, and receivables up to 90 percent, generally under a one-year term.

Short-term credit insurance will be available to protect U.S. franchisors against nonpayment by foreign franchisees due to commercial and political risks. Ex-Im will also offer financing to foreign franchisees for U.S.-made equipment for upgrades, renovations and expansions, as well as franchise fees, training and software.

"We're grateful to Ex-Im Director Pat Loui and her team for this important initiative to support franchise exports," said Beth Solomon, IFA's vice president of strategic initiatives & industry relations. "It demonstrates the increasing recognition of franchising's role in the U.S. economy, as well as Ex-Im's leadership in supporting the exports of U.S. industries."

International Franchisee Financing

In a Wall Street Journal article in August 2009, which dealt with the credit crisis, I stated that most overseas franchisees "are not buying business on credit but are using internal funds." As most international franchisees of U.S. franchises today are companies with a track record, local infrastructure and management talent, internal funds continue to be the main source of licensee financing.

The capital needed to acquire, start-up and operate the international franchise of a U.S. franchisor can range from U.S. $150,000-$10,000,000 depending on the sector, brand and country. While most U.S. franchisors want the international area or master franchisee to already have the capital needed to initially get started, the localization costs, as well as building and operating units, restaurants or stores can be very high. And the build-out cost of additional units may not be able to be met by the cash flow of the first one or two units in a country. U.S. franchisors are starting to help their international franchisees find local and international capital to help with the growth of their business in a country, which means higher royalties coming back to the United States.

During the August 2012 South America Franchise Trade Mission to Panama, Colombia and Chile, co-sponsored by the IFA, the U.S. Commercial Service and Franchise Times, the Managing Director of the Florida-based HASB Global Franchise Finance Alliance, LLC, spoke to the U.S. franchisors on the mission in each country to tell them about possible local and cross-border financing for their new franchisees.

Many franchisors enter international markets with one of two primary strategies: to get a master franchisee or to sub-franchise the entire market. However, access to in-country franchise financing in your target country creates a wider pool of potential franchisees, and can accelerate your growth rate. In many of these international markets, accessing franchise finance with loan to cost/value ranging from 50 percent to 75 percent, and interest rates from 5 percent and up is now realistic. Many in-country lenders have implemented robust franchise financing programs. In some cases, this is anchored by government programs such as the Enterprise Finance Scheme in the United Kingdom, BNDES in Brazil, SME programs in the European Union and so forth.

To create lasting sustainable growth, franchisors should incorporate an "International Franchise Finance Strategy" into their business plans. Such a strategy will enable franchisors to gain a clear understanding of the quantity of capital available to their potential franchisees. The finance strategy would undergird global development plans and facilitate ambitious and realistic growth. Accessing each country's franchise finance customs and culture can mean the difference between growth of 10 franchise units or 1,000 units.

HASB Global Franchise Finance Alliance facilitates the creation of the Franchise Finance Strategy through partnerships with global banks and in-country banks. A franchise accreditation process is required to construct a flow of information that precisely targets the lender's credit risk polices. This analysis on a franchise-by-franchise basis determines the quantity of capital available to the franchisor and typical terms. Once approved by the lenders, HASB team members in that country or region can support and manage the franchisee's loan application process; a complete turnkey process.

The Ex-Im and HASB programs for financing U.S. franchisors' international development here at home and in target countries are only examples of what is possible. As one can imagine, a significant amount of paperwork is required to qualify your franchise and your international franchisees for such programs. But finally there is an appreciation of the value of franchising as an export. ■

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