Franchise Times®

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New Financing Ideas

Think outside the box when searching for funding in 2010

By Dennis Monroe

Regular readers of my column know I am always searching for new financing ideas, and it has not been an easy process in 2008 and 2009. However, I have come up with some new ideas for this month's column that are worth considering.

New idea No. 1: Profit split approach

If you are a franchise business owner faced with trying to get a new site open, in many cases you will find aggressive landlords willing to provide economic incentives for the potential operator. This may be in the form of leasehold allowances or possibly, equipment loans.

All of this landlord help is good, but let's look at a new approach, which, in the long run, may be better and create less risk. Rather than looking to the landlord for various allowances, why not go with a straight profit split? Have the landlord provide the necessary capital to get the store open. This capital provides the operator with the necessary dollars and the profit split rather than a fixed payment for leaseholds and equipment lowers and the operator's risk. This approach may end up costing the operator a significant amount of cash flow, but it is a great way to hedge against the uncertainty of the present retail market.

Here is an example: The owner is looking to open a new location requiring $500,000 of additional capital investment. The landlord is willing to charge $20 per square foot for the space and is receptive to being a partner in the venture. What is proposed is a straight space lease for $20 per square foot and $500,000 provided by the landlord for the additional capital necessary to open the site. Then a determination is made on a pro forma basis of how the cash flow from this new site will be split. A typical split would be something in the neighborhood of 60/40 (60 percent to operator and 40 percent to the landlord/investor). The cash flow amount is determined after payment of all operating expenses and a reasonable management fee (something in the neighborhood of 3 percent to 5 percent). The anticipated landlord/investor return is between 12 percent and 18 percent. This is an above-market return with a market rate for the space leased out.

Obviously, this works only when the landlord has available capital, but it is something to consider.

New idea No. 2: A new kind of sub-debt

I have seen a number of wealthy individuals, frustrated with traditional market-type returns, provide a new type of sub-debt to the franchise business owner to get an above-market return. This is a straight unsecured or subordinate debt that yields somewhere between 12 percent and 16 percent. This sub-debt usually requires a personal guaranty by the key operators.

In most cases, the required personal guaranties for this type of capital are more for keeping the operator honest than actually looking for a form of repayment. If the guarantor has the resources to be able to repay the loan, he probably would not be looking at the sub-debt. This money is available from private individuals who are risk-tolerant. Check with your lawyers, accountants and other financial advisors who may know wealthy individuals willing to invest for a higher yield with certain risk.

New idea No. 3: Family offices

There are still many families who have significant wealth. Many of these families have hired finance professionals to run the family offices and manage investments. Much of this investment activity is done in a consistent manner with how the wealth was obtained but there are always some discretionary funds. Family office investments may be a great source of funding if you are able to show significant entrepreneurial spirit and exhibit a strong track record of being able to perform. Most large metropolitan areas have family office associations, which are key depositories of funding that can be utilized for growing businesses. Once you have shown an appropriate return and pay back the funding, this can be an unlimited source of money for growth.

New idea No. 4: Investment clubs

The idea of investment clubs began developing in the late 1970s with the growth of the stock market. Small groups of investors got together and pooled their resources to take advantage of more expansive investing. These groups were mostly disbanded in the early to mid 1990s, but we have seen a re-emergence of these investment clubs with the idea of spreading risk in the re-emergent market. The approach with these groups is to make a presentation at the club meetings that outlines the desirability of investing in a franchise business. In most cases, these clubs are not going to have the amount of money to fund a full project; however, if two or three of these groups get together, they may have enough resources to fund some degree of development. Normally you can access these investment clubs by speaking to brokers who may be looking at providing these groups with investment services or financial planners.

New idea No. 5: Life insurance funding

Another idea to consider is tapping your (or another person's) existing life insurance in the form of a loan. Many people have ignored their life insurance policies for years; and while these policies have not performed well in recent years, they may still have accumulated a significant amount of cash value. Loans against the cash value in life insurance policies have low interest rates; and if repaid, allow the policy to continue to grow as originally projected.

New idea No. 6: Brokerage accounts

With the stock market going back up, it may be time to look at your stock brokerage account. These accounts have always allowed for the ability to margin or borrow against them. In the past, this has been problematic because of declining stock values. Now may be a good time to look at borrowing against stock accounts or look to your friends who may (if paid a fee) use their stock accounts as collateral for a margin loan. The beauty of this type of loan is that it typically has a very low interest rate and the collateral is provided by the securities account and not by the business assets.

Hopefully these ideas will help you find funding to grow your franchise business. Also, always look to your franchisor for other ideas and contacts. FT

Next month's column will discuss the top financial mistakes franchisees make.

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