IFA
INTERNATIONAL FRANCHISE ASSOCIATION

Setting International Fees Survey Findings

Introduction and Methodology:

In the summer of 2017, the International Department of the International Franchise Association conducted a survey of IFA members with the intent of learning how franchises set international fees. The survey was conducted from July 17 until Aug. 14 through the SurveyMonkey platform. In total, the survey yielded 57 responses from a wide array of sectors including automotive, commercial and residential services, quick service restaurants, real estate, retail, and business and personal services.

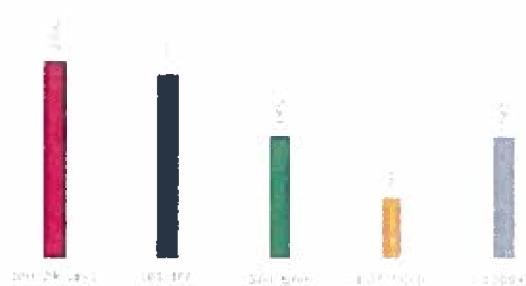
A clear inverse relationship has been established between the length and complexity of a survey and the response rate from IFA members. IFA therefore elected to keep the survey brief in hopes of achieving an adequate sample size (with a goal of 50 responses). The target sample size was achieved, but the limited number of questions left ambiguity in some responses that could be addressed in a more detailed survey. In the analysis of findings, answers to open, narrative questions like "How do you calculate initial fees?" were grouped into primary categories of response. The open questions and diversity of the answers means that these categorizations reflect the subjectivity of the responses. For example, 25% of respondents said they calculated initial fees based on cost recovery and 16% said they charge a fixed amount. If a franchisor applies one calculation of cost recovery to all countries, then they could fit into both categories.

Sample responses are included to provide a fuller picture of the nuance of the answers. Light edits or redactions were made to some responses to maintain anonymity. Due to the diverse and subtle nature of the responses, if further research were conducted, an interview format would be best suited to providing the greatest clarity.

Findings:

The top three sectors of respondents were personal services (24%), business services (20%), and retail products and services (19%). The survey featured a healthy variance in scale of international operations, with 41% of respondents having units in a modest 1-3 countries; 20% in 4-10 countries; 20% in 11-30 countries; 20% in 30+ countries. Compositionally this was also the case with the total number of units worldwide: 29% of respondents had 100 or less; 27% of respondents had 101-300; 18% had 301-600; 9% had 601-1,000; 18% had more than 1000. 21% of respondents featured global system-wide sales (USD) of $25 million or less; 20% had sales of $25 million to $99 million; 32% had sales of $100 million to $299 million; 13% had sales of $300 million to $1 billion; 14% had sales of more than $1 billion. Combined, this data would suggest the survey respondents in size, scale, and scope represented a mix of businesses ranging from small operations in a limited number of countries, to those with sales and operations spanning the globe.

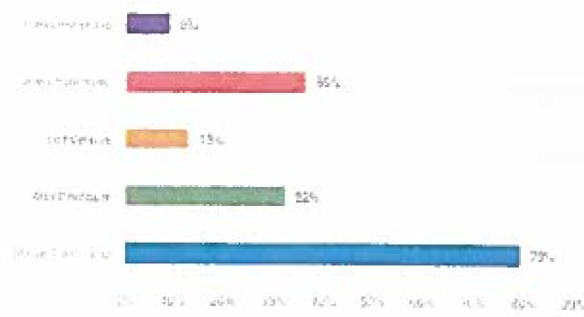
FIGURE 1.0: HOW MANY UNITS DOES YOUR SYSTEM HAVE?



International Development Models

Master Franchising (subfranchising) was the overwhelmingly most-used international development model at 79% of respondents, more popular than the other two most-used models (Direct Franchising at 35% and Area Developer at 32%) combined[1]. More respondents set their initial fees based on cost recovery (45%) than profit-seeking (42%). The survey reflects that franchisors pick the development model to match the market. Two-thirds of franchises with the greatest global presence (operating in 30+ countries), and 73% of those with a moderate global presence (11-30 countries) relied on an assortment of development models. Canada likely accounts for the surprisingly high rate of franchisors using the direct franchising model outside home borders.

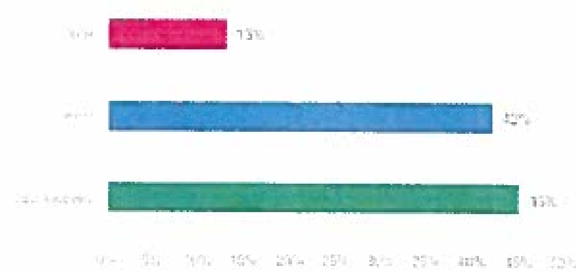
Figure 2.0. Which international development model(s) do you use?



Calculating Initial Fees

In terms of calculating initial fees, respondents' answers mirrored their diverse experiences and were more unique than uniform. Only 16% of respondents based their initial fees on a precise/ predetermined "flat" amount, "minimum fee," or sum of territory and licensing fees. These ranged from as low as $8,500 including one-time fees to as high as $300,000. The remaining 84% of respondents varied greatly in how they determined their initial fees. 35% of respondents based their initial fees either entirely on population of the country, or on a formula wherein population was considered alongside other metrics evaluating the relative size of the economy in question (GDP per capita, demographics, geography, etc.). Going deeper, this was even more likely for respondents in commercial and residential services: 80% factored population into their initial fees.

Figure 3.0. When setting initial fees do you seek:



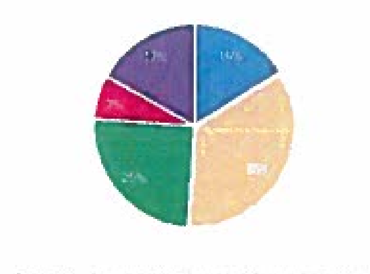
On the whole, 25% of respondents specifically mentioned cost-recovery for travel and associated training costs as a factor in their calculations. This was especially the case with table and full-service restaurants, with 100% of respondents citing cost-recovery as a factor in calculating fees.

Examples of response "Other" to question of whether franchisor seeks profit or cost recovery:

- Our fee structure is set up to cover some portion of our initial cost, but also set up to make sure a developer is fully committed to the development effort.
- Combination of recovery of initial costs as well as first-year support costs, in addition to a small margin.
- Per unit that can equitably be put under contract in the market and the real estate to support growth.
- Cost recovery, profit and reasonable ROI for franchisor, master franchisee and international subfranchisee.

7% simply copied their fees in the United States, converted to the local currency. Interestingly, the relative size, and global presence of the franchise seemed to matter little in this case. For illustration, Franchise A, with over 1,000 units in more than 30 countries and upwards of $1billion in revenue set their fees based on their domestic US fees, as did Franchise B, with 101-300 units in 1-3 countries and $25 million to $99 million in revenue. Overall, there doesn't seem to be a "one size fits all" approach to calculating initial fees.

Figure 3.1: Calculating Initial Fees



[1]A franchise may use Master Franchising in Country A, Area Developer in Country B, and Direct Franchising in Country C, hence totals greater than 100%, as respondents are employing multiple models at once.

Representative responses to the question "How do you calculate initial fees?":

- As far as fees go the rule of thumb we start with is the number of units in the deal multiplied by the unit franchise fee (in the US). We then typically ask for a minimum of 50% of that upfront and the balance as the stores open. This is modified by factors such as the size of the brand, does it already have name recognition internationally, what is AUV etc.
- In smaller markets we normally set a minimum Master Franchise Fee which may be more that 50% of the unit fees.
- Initially determined using a population and GDP per capita formula and then reviewed in the context of a sophisticated financial proforma.
- It's a bit of art and science. Determination is made on the size of the market and number of locations and the opportunity for the Master. 10 units X our standard fee, and often use 50% of that as a baseline.
- Total cost to train and set up Master Franchisee including travel. Then we add a per capita fee based on population in upper-mid to affluent communities.
- We have two sets of initial fees: Territory Fees ... $10,000 per unit charged to secure exclusivity. License Fees ... $35,000 per unit for a 20-year license to operate a location.
- Cost of all the expenses, including back office supervise support, training, legal, market research, POS, supply chain research, interior design support, menu development support, and site selection support.
- • We consider the master franchise fee a "rights fee" as opposed to an advance payment of initial franchise fees. However, the master franchise fee is generally scaled up or down depending on the size of the market. Our minimum master franchise fee is $150,000, and an average fee would be approximately $300,000.
- Fees are based on those set by brand in the US.
- For Direct Franchising, it is flat fee. For Masters, we do a 5-year return on investment analysis based on 50% of the Forecasted Development Schedule, taking into account royalties and Franchise Fees.
- Partly art, partly science. And it varies depending on whether it's a country where we can provide very significant ongoing operational support (e.g., Canada) or a distant country operating in another language where we can't help them much on a day-to-day basis.
- Four considerations: 1.) costs of entry and support of the Master, 2.) prior comparable sales by us/client, 3.) prior sales data from a competitor, if available, 4.) royalty potential and how those initial fees may be paid
- We estimate our direct costs that are expected and see how palatable they are. We then added a bit of a buffer

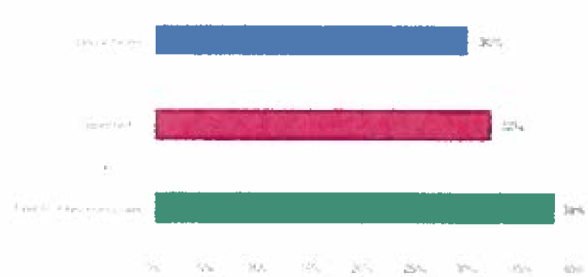
Calculating International Royalties

Respondents were much more uniform in how they calculated their international royalties. 38% of respondents calculated their international royalties based on a fixed percentage of either the franchisee's gross sales or revenue, ranging from 1% to 7%.

32% of respondents calculated their international royalties using their domestic US royalties, either simply matching them or using their US royalties as some form of benchmark/variable. There are not clear correlations in the types of franchises that choose this approach.

The remaining 30% of overall respondents utilized varying factors including market size, industry standards, and blended models designed to account for fluctuations in currency rates and the economics of the country in question.

Figure 4.0 Calculating International Royalties



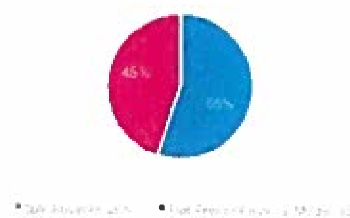
Representative responses to question "How do you calculate international royalties?":

- International royalties paid to master franchisee and franchisor are a fixed percentage of gross unit sales.
- Use the same formula as US and give flexibility to Master with-in reason 1-2%.
- We calculate cost to maintain our franchise infrastructure plus 25% and divide by 100.
- 25% of U.S. royalties.
- 4% of gross sales.
- Similar to US royalties, 6%. May negotiate a bit depending on store volume or strength of franchisee.
- 3.5% royalty on all revenue of any company owned franchise plus 25% of sub franchise initial fee and 20% of royalties from sub franchises paid to master.
- Based on gross sales. The % amount is based on history, growing power of brand, level of support we provide, number of units opened, etc.
- Based on industry average and at the same time, we will lower the royalty to give our franchisee more benefit.
- Royalties according to our US Market.
- We use the same model adjusted for GDP per capita minus the population below the poverty line and award one franchise per 100,000 people.
- We leave that to the Master, with a 1.25% minimum share to us.

- They are even in all countries at 3% for company owned locations and 16.6% for sub franchisees.
- We have a blended model. We use our basic U.S. model of fixed and variable fees. Based on per-capita GDP, we take a ratio of the U.S GDP and the new country GDP and factor our fixed fees based on this ratio. We then compare to other like-kind economies that we're currently operating in and adjust. This enables us to ensure that any calculation remains within an acceptable range; not an outlier on either the high or low side. We have two fixed fee components. For our variable fees, we use the same factor as in the U.S.
- It is flat percentage. We make sure that it covers our franchise training and support costs plus profit.
- They are set in the currency of the home country. This presents challenges, as many of our franchisor expenses are in USD. However, many of the major suppliers do not offer their services in any other currency, and we do not think it would be ideal to charge franchisees a foreign royalty fee. We just ensure that there is enough margin in our royalty calculations and fees to accommodate fluctuations in currency rates.
- We use the same royalty percentage as we do for domestic units, paid in USD.
- Market conditions balanced with US royalties, layering on higher operating cost for the market.
- In a scenario where the MF won't get much ongoing direct support from us, we set a high initial fee and low ongoing royalty (1-2%). In a scenario where we will continue to be directly involved in support, we charge a lower upfront fee and higher royalty.
- Benchmark from US and international market royalties paid from a client, 2.) Competitor royalty structures, if know or applicable, 3.) costs and profit objectives.
- 50% of royalties collected for first 50 stores opened, then 20% of royalties after that.
- Flat for all - 7%.

Calculating Percentage of royalties that go to the master franchisee

Figure 5.0 Calculating Division of Royalties with Master Franchisee



In terms of dividing royalties, 55% of overall respondents relied on splitting royalties as a percentage. Of this group, 48% relied on an even 50/50 split between franchisor and franchisee, and 52% relied on varying percentages: 4% favoring the franchisor, 48% favoring the franchisee. As the number of units increased, the franchise was less likely to rely on a 50/50 split: only a quarter of respondents who split royalties 50/50 represented the upper range of number of units in their system (601-1,000 and more than 1000).

The remaining 45% of overall respondents relied on fixed fees or financial modelling to calculate the split of royalties with their master franchisee.

Figure 5.1: Splitting Royalties as a %

Overall however, there were no discernable trends based on sector, extent of international presence, or revenue.

Representative responses to the question "How do you calculate what percentage of royalties go to the master franchisee?":

- In the Master Franchise Scenario the royalty split is typically between 50/50 to 70/30 in favor of the Master Franchisee.
- We determined the gross royalty and split of royalties between franchiser and master franchisee as a result of financial modeling exercises that looked at EBITDA projections for years 3, 5 and 10 for zor and MF and the correlation between EBITDA and royalty percentage.
- We generally use a guideline of 50%. However in markets where costs are less we might consider a lower fee so a lower royalty can be charged and remain competitive.
- We charge $500 per month per sub franchisee. The MFee keeps everything over that amount.
- 50/50 split between franchisor and Master.
- 3% for the Franchisor, Balance for a Master.
- It is a set fee across all markets.
- Master franchisee pays royalty percentage and master is free to charge different royalties to subfranchisees.
- Compare our brand with others, then look at their royalty fee.
- We offer 20% to masters.
- Depending on what the market will bear, the Master Franchisee can expect a 3-4% royalty.
- Generally we receive 1/3 of initial and ongoing fees paid to the master franchisee by sub-franchisees, and the master franchisee retains 2/3.
- Based on the level of support involved. We have three Tiers. If Tier 1 and 2 delivered (which is the standard), we provide 50% of royalties. If only Tier 1, we provide 40%. Tier 3 is always delivered by Franchisor (very specific and out of the ordinary cases).
- Up to them- we get 1% of GS and they usually charge 5-6% of GS so our portion is 15-20%.
- Master costs to support system and allow Master to objective profit objective, 2.) Franchisor costs and their profitability.
- Anything over 1.8% or $9k per license goes to Master.
- Unit economics and insuring success of Master.

- Typically some negotiated amount. There is no formal calculation.
- Subs pay 20% - we get 7%, master keeps 13%.

Calculating required marketing spending

37% of overall respondents require their franchisees to spend a minimum amount on marketing, ranging between 1-7% of sales or revenue. 38% route marketing fees through the franchisor in varying forms (marketing/brand development/ad funds), while 13% do not route through the franchisor; the remaining respondents did not clarify the flows of their marketing spending.

8% base their required market spending on their US numbers. The remaining roughly two thirds of respondents varied greatly in their individual responses. One third said the question about calculating required marketing spending was not applicable, or that they do not require a fee or minimum spend.

Representative responses to the question "How do you calculate required marketing spending (if applicable)? Is any portion of required marketing spending routed through the franchisor?":

- Require that the Master Franchisee spends a minimum on marketing. Typically 2 - 5% of turnover. Controlled by the franchisee. Unless there is already an international presence Master Franchisees are typically not required to contribute to the ad fund.
- We require that a master franchisee collects minimum of 1% marketing fee from their franchisees, but we permit them to charge more subject to our approval. We do not receive any of the marketing fee - it is to be used in the territory.
- We charge a straight fee now of .50% 1/2 of a percent of sales. We also ask they set-up a local AD fund of 2% with the .50 % going to US and the 1.5% staying local.
- We only suggest and do not require an ad fee paid to us outside the U.S.
- Provide suggested amount of 1-2% of net sales on local spend.
- We collect 1% that comes to us as a marketing/brand development fund that is used to customize creative and other materials for that country. We require at least 2% of sales to be spent locally by the franchisee which we don't touch. Significantly more than 2% is typically spend in the first 2 years to kick start the brand in the new country.
- None required.
- Minimum of 4% Ad Spend with the right to increase to 7% over time. A portion can be allocated to the franchisor.
- N/A. Although our agreements require a certain minimum amount is spent every year (1% of Gross Sales), we do not enforce this.
- A 5% local marketing spend is required. We reserve the right to require a portion of the marketing spend to be routed through the Franchisor.
- 2% of gross revenues. There is 1% of revenues routed to franchisor.
- 3.0% by zees in market, 0.125% of sales to international brand development.
- We want most all marketing dollars to remain in country. We have a very small, fixed fee per unit paid to a Global Ad Fund that we use for major global-wide internet initiatives. We recommend but don't require a master to charge for local marketing. Our masters either use a fixed fee per month per unit or a variable fee based on sales. The predominance is the variable fee, and we find it is most effective in building a robust marketing fund.
- They must spend a minimum amount on marketing for franchise development that is based on the estimated costs that would be required to hit their mandatory development schedule in terms of new franchisees.
- Marketing fees are the same globally and paid to franchisor. We do not dictate local spend.
- We use the standard US of 3%, but require 1% to come to domestic fund for brand.
- 5% of sales.
- We have a National Brand Fund for every country or region, same amount as in domestic units.
- 2% of gross sales in a country fund- nothing comes to franchisor.
- Internationally, no. Typically 1-6% of gross revenue is required to open a market.
- We supply all marketing material to the Master Franchises and they pay for converting it in their language. We also provide all online marketing services.
- Percentage of sales. We have them collect but we have audit rights and ability to charge local Brand Fund for our services.

Additional ongoing fees

42% of overall respondents did not have any additional ongoing fees. 19% charged an additional technology fee for web hosting or software. 10% charge a training fee.

Respondents in the commercial and residential services sector did not charge any additional fees. Only one third of respondents in the quick service restaurants industry charged additional fees. 88% of respondents in the retail products and services sector did not charge any additional fees. 55% of those respondents who charged a technology fee were in the personal services sector.

Representative answers to the question "Do you have additional ongoing fees? If so what are they and how are they calculated?":

- Franchisee pays our travel expenses.
- We receive 10% of all unit franchise and area rep fees charged by the Master Franchisee. This percentage was determined through our modeling exercises and with the objective of reasonable ROI for franchisor and MF. And we sell exclusive products that are used in international franchise locations.
- We charge directly for web hosting fee's, transfer fee, renewal fee's, etc.
- No, we only charge the flat fee royalty.
- Opening fees ranging from $2,000- $5,000 depending on size and format of the unit
- We charge a training fee to complete initial training and send a team of trainers to the first two openings in a new country.
- Only cost recovery of any subscription fees if we pay them on behalf of a franchisee
- Store opening fees and some sublicense/subfranchise splits. For instance, we receive a percentage (such as 30% or 40%) of the initial fee that that the master charges a subfranchisee.
- We have clauses in each contract to address additional training and support on an as needed basis.
- Software fees. same cost as US franchise.
- We have a monthly technology fee per sub-franchisee, and we share in a percentage of vendor rebates and training fees.
- Technology, which is a flat fee and subject to change annually.
- In addition to the split on franchise fees and royalties (which may be 50/50 or 60/40) we also charge an extra 10% on franchise sales if they choose to have us involved in the franchise sales process.
- $100 tech fee.
- Fee for income derived from restricted purchases. Monthly technology fee.
- There is a renewal fee of 10% of the franchisee fee paid at the end of the term to renew for another period.
- Ongoing training fees, compliance related costs (including travel) and fees for updating materials.
- 9k per license awarded.
- Miscellaneous such as training fees...we get 20% of what they collect in return for using our materials. We train their people at no charge the first year, then a daily fee is charged for training we provide.
- Yes, for services rendered.
- Fees for software are passed on at cost.
- No extra fees until renewal time.

Key Findings:

- Unsurprisingly, master franchising is by far the most common development model.
- The confusion expressed by the franchise community about setting international fees is reflected in the diversity of responses.
- Even among larger companies, brands in more markets, or in the same industry there is limited commonality of practice in setting initial fees and roy