

Beware of the hidden costs in franchising!

By Ekta Sharma Verma

Many reasons can be attributed to a franchise failure. Besides the obvious reasons like franchisor-franchisee tiffs or lack of proper store maintenance, there are certain hidden costs that affect the brand totally and may result in the total collapse of a store. So, what are these buried costs that cause the menace and how to deal with it? We tell you more on this....

INFORMED or not, hidden costs play a crucial role in the working of a franchise. A franchisor usually will think that the franchisee is aware of all the rules and processes and money involved but by and large there is more to it. A franchisee needs to know more than just the things mentioned on the lengthy franchise agreement sheet.

Must read the agreement

Franchisor of an F&B brand on the terms of not being quoted informed that most of the franchisors across industries impose hidden

costs on franchisees. Therefore, reading of franchise agreement and discussion on it should be made compulsory. Most franchisees are in a hurry and don't bother much to go through the terms and conditions. Here, the franchisor scores and takes advantage. He further added that a franchisee is promised about the trainings and location visits but he is usually unaware about the travel expenses. The franchisees think that it will be levied by the franchisor which is not the case. To maintain the quality of the equipments and stock, a franchisor makes it mandatory for a franchisee to purchase all the goods from the franchisor only. Here also, the franchisees are either unaware or they are not properly informed.

Vivek Shinde, Senior Manager-Franchising, Sane Care who is also a franchisee of Brainbow Academy of Multiple Intelligence agrees that there are hidden costs and it should be carefully addressed. He says: "Hidden costs are and will be there in certain cases and brands. More transparency is needed here. I don't think any business can grow if you cheat your franchisee."

Citing an example Shinde of Sane Care says: "Whenever there is any revamping of the store to be done, a franchisee should be informed well in advance by the franchisor and the costs related to that should be discussed. More

transparency will lead to more success."

Under promise, over deliver

Since India has no strict franchise laws in force, it becomes all the more complicated to stop unethical practices by a franchisor. Anuvrat Pabrai, Mentor and Advisor, Pabrai's Fresh & Naturelle Icecreams has been in the ice-cream trade since 1985. With his expertise he confidently agrees that a few franchisors don't disclose the finer details of the agreement. He says: "A lot of franchisors mislead the franchisees especially when it comes to interiors, fixed capital investment and equipments. Working capital is also kept hidden."

Referring to the same he says: "I have seen this happen in the ice-cream and Gelato Industry where the breakup was never given to the franchisee. After visiting the outlet, I realised that not even 50 per cent of the cost was spent on the interiors and equipments what was taken from the franchisee. Now, after being badly cheated when the franchisee wants to exit, there is not even an exit clause. The franchisee has to finally close down the store and shut his business, losing all his hard earned money. According to me a good franchisor always asks his franchisees to make daily profit and loss statements and shares with him the minute details of the agreement."



Expert inspection

Aarushi Jain, Senior Member of IP and Franchise Team, Nishith Desai Associates says: "Generally, franchisees consider royalty payments as the total franchise costs and fail to factor the 'other' expenses that may be incurred while operating a franchise. These hidden costs may vary depending on the kind of franchise one takes. Cost for obtaining government permits, cost of lawyers, accountant, staff training (which could be high due to high turnover of the staff in the business), staff training, taxes, expenses towards insurance, infrastructure costs (such as rentals, equipment, raw material or staff), penalties or damages for failure to comply with the terms of the franchise agreement, advertising, marketing or consultation costs are the outgoings that a franchisee would typically need to bear in a franchise relationship."

Rod Young, Chairman of Australia based DC Strategy Group asserts: "At DC Strategy we have seen unplanned hidden costs result in a failure to be able to pay suppliers which has

impacted not just the particular franchisee but every franchisee in the network as the supplier withheld stock supplies from the whole group. We have also seen franchisees sue the franchisor for payment of the franchisees accumulated losses claiming the non-disclosure of these hidden costs amounted to false and misleading conduct by the Franchisor which led to the franchisees incurring these losses which resulted in damages and litigation costs being awarded against the franchisor. The primary problem is that the new franchisee is undercapitalised in the most critical period of a new business - the start up phase. This has the potential to cripple the establishment of the business and potentially lead to the failure of the franchise. The second is the breach of trust that inevitably is created because the franchisee believes, correctly, that either the franchisor

Beware of the following

● If an **advertising campaign** is promised to the franchisee, he must make sure that within a decided time it is done else as time passes things are fast forgotten and a franchisee has to bear the advertising cost alone and this wholly affects a brand's image.

● **Bulk buying benefits**- A franchisee must ask his franchisor if he can do bulk buying from outside source or not. Some franchisors do not support this option and a franchisee is deprived of the huge discounts and offers on the goods.


● **Before finalising any deal**, make sure you

meet a few franchisees of the brand to get a clear picture about the brand.

● Since you have to operate to the standards defined by the franchisor, the franchisor may be legally allowed to make you **invest in new services** for the brand. Ask about the same prior only.

● You will have to go on **trainings and site visits**, always ensure the charges are known to you and also if it is incurred by the franchisor or not.

● Always ask about the **initial fee and monthly royalties** involved in the cost of a franchise.

knew, or ought to have known that these hidden costs were actually required to correctly establish the business. As a result the franchisee feels misled by the franchisor which may permanently damage the franchisor/franchisee relationship leading to non-compliance and defiance by the franchisee." 

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