STREAMS *of* HOPE

Social Franchising:
A New Path to Wealth for Nonprofits

A PUBLICATION OF

Community Wealth Ventures, Inc.

and

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FOREWORD BY

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Social franchising is a groundbreaking concept offering nonprofit organizations the opportunity to create reliable, unrestricted wealth to support mission activities. As traditional funding sources become shallow or dry up altogether, social franchising is not only a new stream of income, it's a Stream of Hope. Hope for sustainability. Hope for self-reliance. Hope for growth. And, most importantly, hope for the people and causes that need hope most of all.

Authored and compiled by Community Wealth Ventures, the nation's leading consulting firm to nonprofits, and based on decades of experience with hundreds of community organizations, this publication serves as both an introduction to social franchising and a handbook for those organizations wishing to pursue this exciting concept.

About the Authors

Nonprofit organizations can increase their social impact by building on their own internal assets, rather than relying on support from external organizations.

Community Wealth Ventures was founded in 1997 as a for-profit subsidiary of Share Our Strength, one of the nation's leading anti-hunger and anti-poverty organizations. CWV helps nonprofit organizations become more self-sustaining by generating revenue through business ventures and corporate partnerships. Over the past decade, CWV has helped more than two hundred nonprofit clients plan and execute earned-income strategies and has studied hundreds more as a pioneering thought leader in the field.

Following a 2004 study by the International Franchise Association's Educational Foundation that identified a large potential for social franchising, CWV launched Social Franchise Ventures. Built on CWV's years of social enterprise experience, SFV works on behalf of nonprofits to identify and screen socially responsible, successful franchisors that fit with mission objectives. SFV assists nonprofits in negotiating a franchise relationship, developing a business plan, securing a lease, raising capital, hiring personnel and launching the franchise, as well as providing ongoing business support to ensure successful franchise operations.

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Preface

Dear Colleague:

We are all operating in trying economic times, marked by volatile markets, unemployment and growing state and federal deficits. There are significant constraints on the ability of government to meet pressing social needs. But against such a bleak backdrop, this report shines through like a beacon, because it offers new ways for civil society to create the flow of wealth necessary to address even the toughest of problems.

By offering a reliable and unrestricted flow of income, social franchising is a vital new funding stream for nonprofits.

For all of us, the ability to achieve our goals is compromised when markets are challenged. But what about when markets don't even exist in the first place? The toughest problems to solve are those affecting people who are so voiceless and invisible that there are no economic markets or political markets for solving them. There is no market for feeding hungry children. There is no market for guaranteeing that low-income children have access to the best public schools. There is no market for ensuring that millions of poor Americans who lack quality health care can become insured. There is no market for developing and distributing a malaria vaccine to African children.

Struggling financial markets win the attention of presidents and prime ministers, investors and bankers, and can be resolved over time. But the lack of markets for those who are voiceless finds no such audience.

That's why it is more important than ever that businesses and nonprofits work together in new ways that bridge such market gaps and generate the resources necessary to address social needs. Social franchises are a critical new stage in the evolution of social enterprise. They bring together proven business models and corporate expertise with the nonprofit organizations that are often a community's most committed stakeholders. Though still in their infancy, social franchises offer yet another option for nonprofits willing to leverage their assets in the interests of the revenue generation needed to expand their mission.

We tend to think of wealth as something that makes our houses bigger and vacations longer and cars faster, but there is another kind of wealth and it's the kind that makes our school better, our kids healthier and our communities stronger. This is community wealth and its creation depends on combining the talents of business and nonprofits. Social franchises are one of the newest and most promising ways of doing so.

Sincerely,

Billy Shore
Chairman, Community Wealth Ventures

Foreword

By John Reynolds
President, International Franchise Association – Educational Foundation

The IFA Educational Foundation is pleased to show its continued support for Community Wealth Ventures and its initiative Social Franchise Ventures. By bringing together the franchise and nonprofit communities, social franchising can truly create Streams of Hope for countless organizations and an equitable course of business for franchisors.

There has never been a better time for nonprofits to enter this market. The Foundation's latest report, "The Economic Impact of Franchise Businesses," conducted by PricewaterhouseCoopers, highlights the breadth and depth of franchising and its growth over the last four years. Franchises in the United States are creating jobs at a faster pace than durable and nondurable goods manufacturing, financial and construction industries. From 2001 to 2005, the franchising sector expanded more than 18 percent, adding more than 140,000 new establishments, while creating 1.2 million new jobs.

There has never been a better time for nonprofits to enter this market.

The nonprofit and franchise sectors are critical to the United States. The two sectors provide jobs, services and resources that keep this country strong. We encourage the efforts of Social Franchise Ventures to bring the best elements of these dynamic sectors together to promote entrepreneurship and the free enterprise system. We thank Community Wealth Ventures for its diligent efforts to open this market by educating franchise and nonprofit leaders alike.

If your nonprofit is searching for a more reliable, expandable and unrestricted flow of funding, we encourage you to consider leveraging the power of franchising to generate Streams of Hope – new sources of revenue and innovation to further your mission.

1 The Need for New Streams

BY BENJAMIN C. LITALIEN

While the demand for nonprofit services relentlessly grows, the availability of funding continually shrinks.

The critical issue facing nonprofit organizations today is sustainability. Society relies heavily on the nonprofit sector's ability to address many of the nation's greatest challenges. Unfortunately, America's problems are far outpacing the public and philanthropic dollars available to solve them. Nonprofit executives are concerned about their ability to invest in and grow their critical programs to meet the long-term needs of society.

Swimming Upstream

To achieve greater sustainability, earned-income generation has emerged as a powerful solution. Across the nation, many entrepreneurial nonprofits are creating successful business ventures to generate revenue streams that reduce their dependence on philanthropy. In fact, according to the National Center for Charitable Statistics, the 1.4 million nonprofits in the United States generate 70% of their revenue from earned income. Despite the successes, however, there are just as many social enterprises that do not achieve revenue goals. Often, nonprofit organizations find the execution of a successful small business to be more challenging than initially thought. While nonprofits often have strong ideas, enthusiasm and compelling assets that can be brought to bear to drive a successful business, they lack the systems, industry knowledge and specific talent to hit the ground running.

The 1.4 million nonprofits in the United States generate 70% of their revenue from earned income.

A Stream Less Traveled

At the same time nonprofits are increasingly exploring social enterprise, the franchise industry in the United States is booming. There are more than 3,500 franchisors with 900,000 franchised business units across nearly 100 different industries. These proven "businesses in a box" offer earned-income opportunities without many of the challenges presented by start-up businesses. By offering established products, structures and support systems, franchising allows nonprofits to focus their resources on managing a business, rather than creating one from the ground up, thereby increasing the chances for success.

While the potential for valuable partnerships between the franchise industry and the nonprofit community is tremendous, it remains largely untapped. There are fewer than 100 nonprofit organizations operating social franchises in the U.S. today. Ben & Jerry's was a pioneer in the social franchise space, creating a unique PartnerShop program for nonprofit organizations in the late 1980s. There are no easy answers to the many questions that must be continually considered and addressed. Like their individual franchisee counterparts, nonprofits have much at stake and are assuming real risks which could include their ability to continue the good works they are doing in communities across this country. Franchisors and nonprofits will find the answers because it bodes so powerfully in the mix of strategies both are earnestly seeking: for nonprofits, the sustainability necessary to ensure they can fulfill their purpose; and, for franchisors, a disciplined approach to participating in social change with the added benefit of differentiation in the ever-crowding marketplace.

Franchising allows nonprofits to focus resources on managing a business, rather than creating one from the ground up, thereby increasing the chances for success.

Benjamin C. Litalien, Certified Franchise Executive
Ben serves as Strategic Franchise Advisor for Social Franchise Ventures and is on staff at Georgetown University's School of Continuing Education as the Academic Advisor for Entrepreneurship and Franchise programs. He is a recognized speaker for the International Franchise Association on "Turnaround Strategies" and "Franchise Development" and has been referenced in feature articles in *The Wall Street Journal*, *USA Today*, *Chain Leader*, *Entrepreneur*, *Supermarket News*, *Successful Franchising*, Convenience Store Decision and *Restaurant Hospitality* magazines.

STREAM *of* HOPE:

BEAVER COUNTY REHABILITATION CENTER

Organization Backgrounds

Since 1962, the Beaver County Rehabilitation Center has provided opportunities for persons who are vocationally challenged to obtain employment with the greatest degree of independence possible. BCRC partners with the business community to assist more than 400 people with disabilities each year. BCRC's school-to-work transition program and welfare-to-work program help disadvantaged individuals to learn the skills and gain the valuable work experience necessary to acquire and maintain a job. The downsizing of its sheltered workshop and subsequent increase in competitive employment opportunities for many of those who had been sheltered employees is just one of BCRC's recent accomplishments.

Candy Bouquet International is the largest candy franchisor in the world, with more than 700 franchises worldwide. Candy Bouquet franchises sell fun and unique arrangements for every occasion that will never wilt, fade or die. Each bouquet is designed like a floral display, using candies, chocolates and accessories instead of flowers. The franchisor currently has three nonprofit franchisees, who, like many other franchisees in the system, were drawn to the business by the simplicity of producing the bouquets and the home-based option that allows franchisees to keep their initial investment low by not utilizing a retail storefront.

AT A GLANCE

Franchise: Candy Bouquet

Location: New Brighton, PA

Year Opened: August 2001

Profitability: Breakeven to marginal profitability

Mission Outcome(s): To provide work and skills training for persons with disabilities and increase community awareness of BCRC and its mission

Legal Structure: Part of BCRC, not-for-profit

How They Got Started

Ten years ago, BCRC decided to open a business to have better control over the types and amount of work it could offer to its clients. The executive committee researched potential business opportunities and came across the Candy Bouquet business. Candy Bouquet was appealing because the work was very labor intensive and the process could be broken down easily into different steps which clients could learn. Candy Bouquet also allowed BCRC's clients to utilize their creative skills through meaningful work. After researching the products more carefully, visiting local franchises and speaking with another nonprofit franchisee, BCRC decided to launch its own Candy Bouquet business.

Over the years, BCRC has expanded into the gifts industry. BCRC currently sells Candy Bouquets as a part of its Gifts Delivered business, which also features silk arrangements, wreaths and other gift products. Candy Bouquets are also sold in two Beaver County-area hospital gift shops. Public response has been overwhelmingly positive, especially during Christmas and Valentine's Day. Additionally, the bouquets have generated excellent PR for the center. In 2000, shortly after becoming a franchisee, BCRC was honored as Candy Bouquet International's "Franchisee of the Month."

Franchise Deal

Candy Bouquet was very receptive to having a nonprofit franchisee. They helped BCRC conduct market studies and demographic research to ensure a successful launch of the business. After six months of negotiations, BCRC was able to acquire a 20% discount on the standard franchise fee of $22,000, which will carry through with each five-year renewal commitment. Unlike most franchises, Candy Bouquet does not charge royalties. Instead, BCRC pays a monthly association fee dependent on its population territory size, ranging from $35-$200. BCRC's initial investment totaled $20,000.

BCRC incorporated its Candy Bouquet business with its Gifts Delivered business, which is profitable due to wholesale orders. Candy Bouquet itself does not generate much profit, because the bouquets are made by clients in sheltered settings and can be very labor intensive. However, as BCRC's executive director, Paulette Miller, states, "That's not our goal. We see success in the number of people we put to work each day. It's more important to us to fulfill our mission than to make money. Our motto is 'We teach work with work.'"

Challenges

Small staff – BCRC decided to incorporate the Candy Bouquet business into its nonprofit entity, rather than to create a separate subsidiary. However, the nonprofit had a small staff, so it was difficult to find people to manage the business. Staff members had to perform many roles, which reduced the amount of time they could devote solely to either the business or the nonprofit.

Lengthy franchise negotiations – BCRC spent six months negotiating with Candy Bouquet before purchasing the franchise. Candy Bouquet only had a few other nonprofit franchisees, so working with nonprofits was still new to them.

Keys to Success

Customized training – BCRC trained its clients individually, ensuring each client understood the bouquet-making process. In addition, BCRC catered to its clients' strengths and encouraged clients to use their creative skills.

Extensive workforce pool – As a nonprofit which provides vocational training, BCRC had access to a large client workforce to staff workers for its business. This made it easier to locate and train employees.

Franchisor support – Candy Bouquet was receptive to a nonprofit franchisee and supportive of BCRC's venture. BCRC wanted to use Candy Bouquet to train and employ its clients, rather than open a typical business. Candy Bouquet made accommodations for the nonprofit as necessary.

Good scalability – Candy Bouquet could be incorporated easily into an existing business or used to expand into other industries because it did not require an independent storefront. Additionally, Candy Bouquets could be sold in multiple locations, allowing for the business to extend its reach.

In-depth research – BCRC took time to develop the business slowly and carefully. It made a detailed analysis of the business costs, considered the steps involved in creating a bouquet to see if it was feasible for its clients and visited other franchises — including a social franchise — to see if the venture was viable. BCRC visited the social franchise specifically to learn more about its nonprofit business model. This preliminary research was critical to BCRC's decision to enter the business because it helped them to understand the process and learn what to expect before opening its business.

Strong management – BCRC had a very proactive executive director who oversaw the entire process, kept BCRC's interests in the forefront and ensured the launch of a successful venture.

2 Testing the Waters: Franchise 101

BY DOUG SUDELL, CERTIFIED FRANCHISE EXECUTIVE

Franchisees are in business for themselves, but not by themselves.

Usually when people think of franchising, they think of McDonald's, Burger King and other fast-food stalwarts. However, food retail represents only 16% of existing franchise units. Franchising is common in a number of other industries – including education, technology, manufacturing, automotive and healthcare. No matter what the industry, the strength of the franchise is that each unit is independently owned and operated by an individual. So any given franchise can benefit from dozens, sometimes hundreds of different entrepreneurs and their ability to grow the business. In return, each franchisee benefits from the proven business model, established brand and strong support of the franchisor.

The Basics

A key benefit of franchising is the economies of scale that reduce the cost of doing business.

Franchising refers to a business model in which an individual or organization purchases the rights to operate a unit of an already established business, leveraging the owner's brand, systems and philosophy. After the initial payment of a franchise fee and investment in required infrastructure, the franchisor grants the franchisee the right to distribute its products, techniques and trademarks. The franchisor typically charges an ongoing percentage of sales, referred to as the royalty. In addition, the franchisor works to protect and grow its brand through various activities such as national or international advertising, training and other support services, thus benefiting all of its franchisees.

The dominant mode of franchising today is called "business format franchising." It involves creating a highly structured business model and providing extensive training to franchisees in marketing, sales, accounting, recruiting, store design and other key areas in order to ensure a greater level of uniformity.

The sale of a franchise is highly regulated. In the late 1970s, the International Franchise Association worked with Congress and the Federal Trade Commission to create a system of self regulation for franchise offerings. Today, all franchisors are required to annually publish and update the Franchise Disclosure Document (FDD) – a legal document intended to provide prospective franchisees with enough information to help them make an educated decision about buying a franchise. A typical franchise agreement lasts five to twenty years, with premature terminations of most contracts bearing serious consequences for franchisees.

A Stream of Benefits

Purchasing a "business in a box" allows an entrepreneur time to focus on tackling the day-to-day challenges of running a business, while the franchisor bears responsibility for the more macro and long-term business needs. Compared with traditional start-up businesses, the stream of benefits that can come from owning a franchise is wide and deep:

Strong Brands

Franchisees can start a new business that already has name recognition and a loyal following of customers. Franchisors take brand building very seriously, as it is the lifeblood of their business, so they focus on strengthening the brand through, among other things, effective marketing. As part of the franchise system, franchisees access tested marketing materials to use locally and benefit from shared marketing spends regionally and nationally. Franchisors often provide "ready-to-use" public relations materials, print advertising, direct mail, point-of-purchase displays, sales promotions, customizable broadcast spots and more.

Operational Expertise

Franchisors consistently work to improve operations and stay ahead of technology. They share best practices and work to reduce costs while improving service delivery. This effort lasts throughout the life of the franchise agreement and helps the franchisee maintain the competitive advantage that made the franchise a compelling investment in the first place.

Training and Support

Franchisors can often train an entrepreneur to run the business in a matter of weeks. Initial training usually lasts between two and five weeks at the franchise headquarters, with a combination of classroom and in-field training. It can also include on-site instruction as well as ongoing support through the life of the franchise agreement.

Liquidity

Relative to similar independent businesses, franchises offer a higher level of liquidity, meaning there is an increased likelihood of being able to sell the franchise unit, if desired.

Economies of Scale

A key benefit to doing business as part of a larger system is the economies of scale that reduce the cost of doing business. Because the franchisor has an aggregated negotiating and purchasing power, it can drive costs down. This advantage increases as the number of units increases. Additionally, franchisees benefit from reduced administrative and marketing costs and increased training resources because the franchisor aggregates best practices and shares them with franchisees.

Ability to Expand

The franchise model rewards multi-unit owners. The cost to acquire a second franchise is often less than the first and, as an experienced operator, there is less costly training needed with each new unit. Multi-unit owners also benefit from their own economies of scale and the flexibility to shift inventory or employees from one unit to the next.

Planning Transparency

Prior to launching a franchise, an entrepreneur has access to the existing franchisee system, as well as to existing franchise owners, to help understand the risks, requirements and performance expectations. This reduces the unknowns of launching a new business.

Looking Downstream

In exchange for attractive returns in a relatively short period of time, franchises carry a number of upfront and ongoing costs. Franchisors are required by law to share all costs and fees directly associated with launching the business and must also disclose any ongoing payments and renewal fees the franchisee will incur. All franchisors require an initial franchise fee, some level of investment in infrastructure or build out and an ongoing royalty.

There is only one way to truly understand the potential return on investment when purchasing a franchise – speaking with existing franchisees. Individuals actually running the businesses can help potential franchisees understand market drivers, franchisor support, franchisor-supplied marketing tools, product quality and pricing structures. This information – along with local market research and requisite business planning – can be used to determine expected returns.

A CLOSER LOOK AT FEES

Initial Franchise Fee: In 70% of franchises, this fee is less than $30,000

Initial Investment: In 75% of franchises, initial investment (including all costs to build-out, initial inventory and start-up working capital for three months) costs less than $250,000

Ongoing royalty: Typically, royalty is between 4 and 8% of gross sales. This pays for the continued use of the franchisor's trademark and ongoing service and support.

Doug Sudell, Certified Franchise Executive
Doug is a consultant for Social Franchise Ventures, bringing a background that is a unique fusion of franchise and nonprofit experience. Doug spent more than four years as a Field Consultant in the Subway organization, during which time he supported more than 50 new store openings in and around New York City and worked with Subway headquarters on training and support development initiatives. He has also managed small business support programs at a community economic development corporation in Brooklyn, NY, and as a U.S. Peace Corps Volunteer in Honduras.

STREAM *of* HOPE:
EVERGREEN COMMONS

Organization Backgrounds

Evergreen Commons is a nationally recognized organization that serves adults age fifty and older and their families. Evergreen Commons enhances the social, physical, emotional and spiritual quality of life for individuals within the context of Judeo-Christian values. Its services and programs encompass both leisure activities and basic needs, such as respite care, nutrition, home safety and social-worker assistance.

AT A GLANCE

Franchise: American Ramp Systems

Location: Holland, MI (No retail storefront – products stored in warehouse)

Year Opened: July 2006

Annual Revenue: July 2007-June 2008 gross revenue $211,000

Profitability: Breakeven in first 12 months. July 2007-June 2008 net income $51,000

Mission Outcome(s): To enhance the quality of life for mobility-impaired persons by providing high-quality and cost-effective ramps

Legal Structure: Wholly owned and operated by Evergreen Ramps, for-profit

Additionally, the Evergreen Commons Senior Center is a highly regarded model for developing senior communities across the country because of its impressive and diverse range of services. Evergreen Commons' programs include: a community-based health resource for older adults and their caregivers, a fully equipped fitness center, an enrichment department with both leisure and educational activities to promote lifelong learning, a resource services department, an on-site and in-home respite program and various service opportunities.

American Ramp Systems (AmRamp) is a national provider of quality wheelchair ramps and portable roll-in wheelchair showers. AmRamp offers free in-home evaluations and sells, rents and installs ramps with a patented slip-reducing surface. Unlike permanent wood or concrete ramps, modular ramps from AmRamp usually do not require permits, contractors or property-tax assessments.

How They Got Started

After examining an AmRamp exhibit at an industry conference, Larry Erlandson, President of Evergreen Commons, realized that selling ramps could be a successful way to fund the nonprofit's programs. Erlandson explained, "As a nonprofit organization, I'm always looking for ways to diversify our revenue sources." Evergreen Commons is primarily funded by traditional sources, such as program fees, membership dues, grants, government service contracts or donations. Yet the success of their previous business venture, Family Fitness Center, demonstrated the great potential of social enterprise to generate profit, while simultaneously serving the needs of the community.

Evergreen Commons contacted American Ramp Systems because AmRamp's high-quality and cost-effective products aligned well with Evergreen's mission of serving the disabled and elderly. After conducting further market research, Erlandson proposed his plan to the Board of Directors. Through a combination of fundraising and an investment from the nonprofit's endowment, Evergreen Commons was able to launch its AmRamp franchise in the following year. Evergreen Commons hired a general manager with prior experience in sales to run its franchise on a commissioned salary.

Franchise Deal

Evergreen Commons paid a standard initial 3% in royalties (which progresses to a 12% royalty rate over four years) and a $139,000 franchise fee to AmRamp for a territory of $2.65 million. The total startup investment was $175,000.

Challenges

Fundraising – Evergreen Commons had an endowment fund. However, in order to convince the Board of Directors to invest in the AmRamp franchise, Evergreen Commons had to raise a portion of the start-up costs independently. This delayed the franchising process by one year.

Sales – The majority of clients were first-time buyers who did not know the typical costs of ramps, making it difficult for Evergreen Commons to highlight the affordability of its ramps to clients. Additionally, Evergreen Commons underestimated the effect of seasons on product demand. The fall and winter months yielded fewer customers than the rest of the year. Due to these challenges, it was difficult for the organization to meet its projected sales volume in the first year.

Keys to Success

Existing synergies – Evergreen Commons had a strong prior understanding of its clients' needs. The organization's partnership with AmRamp furthered its nonprofit mission of enhancing the quality of life for seniors.

Previous business experience – Evergreen Commons was already operating a successful Family Fitness Center, which helped it to understand and manage the challenges that can arise from overseeing business operations. Additionally, many of its staff and members of the Board of Directors had business experience.

Evergreen had a strong understanding of its clients' needs. The partnership with AmRamp furthered its nonprofit mission of enhancing the quality of life for seniors.

Social network – Evergreen Commons had many existing relationships with elderly persons in the community through its nonprofit work. It was well respected by many older adults and their caregivers. Additionally, it had good relationships with other organizations that served the disabled and the elderly. These social networks helped Evergreen Commons to build its client base for the AmRamp business.

Realistic expectations of ROI – Evergreen Commons anticipated little to no return on investment during its first few years of operation. However, it secured enough working capital to fund the operations until projected profitability.

3 The Legal Stream: Staying Tax Exempt

BY JENNIFER REEDSTROM BISHOP AND SARAH DUNIWAY

Is social franchising legal? Only if it's done right.

When nonprofits consider entering the into a for-profit arena, the first question is usually, "Is this legal?" A nonprofit organization spends its entire existence obtaining and retaining precious exemption from taxation under Section 501(c)(3) of the Internal Revenue Code. So, when a nonprofit considers an unrelated business venture with a different tax classification, it's natural that the big legal question arises. The quick answer is, social franchising can be a completely legal entity, provided it is executed correctly.

The Nonprofit Structure

A nonprofit is simply one type of a corporation. Just like a for-profit business, nonprofits are permitted to make a profit. It's the use of the profit that is limited. For instance, a nonprofit cannot pay out dividends to individuals nor can individuals "own" stock or other interests in a nonprofit.

Just like a for-profit business, nonprofits are permitted to make a profit. It's the use of the profit that is limited.

A nonprofit corporation may engage in activities that look like regular business activities. In fact, nonprofits use their money every day to own a piece of a for-profit business when they make investments. However, the difference between owning stock in Microsoft and owning an unrelated business enterprise, like a franchise, is that the franchise is not just a passive investment. It's an operating activity of the nonprofit. So, from a legal perspective, it needs to be analyzed differently.

Staying Tax Exempt

In order to retain tax-exempt status, a substantial portion of the activities of a tax-exempt nonprofit must be related to its tax-exempt purposes. A nonprofit cannot devote a majority of its time to activities unrelated to its tax-exempt purposes. For example, a local orchestra may sell greeting cards at a fund raiser. The sale of greeting cards is not related to the exempt purposes of the orchestra (education, improving the community), but if the revenue and time spent in the fundraising activity is "insubstantial," the activity won't harm its tax-exempt status. The orchestra, however, will pay tax on the greeting-card revenue as unrelated business income.

It's important to understand that dedicating the proceeds of an unrelated business activity to a nonprofit's exempt purposes does not transform an unrelated activity into a related activity. To do that, the core of the activity itself must further the mission of the organization. For example, where a nonprofit organization provides work training for individuals with developmental disabilities, having those clients clean hotel rooms can be a related activity. In contrast, a tax-exempt liberal arts college can't raise funds for scholarships by starting a cleaning business and expect that business to be considered related to its educational mission, no matter what it does with the proceeds.

The relationship between the charity and the for-profit business must be carefully structured to remain at "arm's length."

The Legal Social Franchise

Applying the above rules, a charity that buys a franchise may keep the franchise's activities inside the charity and directly engage in the business without jeopardizing its tax exemption, as long as the revenue produced – and time spent – is insubstantial. Although that term is not defined by the IRS, an activity is generally considered to be insubstantial if it consumes no more than 10% of the time and revenue of the organization. The net income of that franchise activity will be subject to corporate income tax as unrelated business income.

If the amount of activity is projected to be (or grows to be) greater than 10% of the time and revenue, the charity can form a for-profit subsidiary. The charity would own 100% of the stock of the for-profit business and receive 100% of the dividends. The relationship between the charity and the for-profit business must be carefully structured to remain at "arm's length" and ensure that the charitable assets of the charity don't unduly benefit the for-profit entity. But those relationships can be crafted to satisfy the IRS.

It may not be simple, but it is clear that a nonprofit corporation can engage in social enterprise activities, including franchising. Properly structured, it's legal.

Jennifer Reedstrom Bishop and Sarah Duniway
Jennifer and Sarah are principals in Gray Plant Mooty's Tax-exempt & Nonprofit Organizations team where they specialize in working with nonprofits on a variety of legal and tax matters. Jennifer may be reached at 612.632.3060 or jennifer.bishop@gpmlaw.com, and Sarah may be reached at 612.632.3055 or sarah.duniway@gpmlaw.com.

STREAM *of* HOPE:
WESTHAB

Organization Backgrounds

Westhab works to enable homeless and low-income individuals and families to become self-sufficient, and further the physical, social and economic stability of distressed neighborhoods by developing affordable housing, revitalizing communities, and providing critically needed adult and youth services.

AT A GLANCE

Franchise: Andy OnCall®

Location: Elmsford, NY

Year Opened: 2005

Annual Revenue: Approximately $480,000

Profitability: Unprofitable first and second years, almost at breakeven in third year until economic downturn

Mission Outcome(s): Currently contracts eight full-time and three part-time craftsman (though none of them is a client of Westhab)

Legal Structure: Wholly owned for-profit subsidiary

Since 1981, Westhab has provided more than 4,000 homeless families in Westchester County, New York with permanent, affordable housing. In addition, Westhab works to improve neighborhoods. Westhab provides critical supportive services through case management, comprehensive employment and training programs, normative community models and training, life-skills training, infant and child day-care provision, a wide array of comprehensive children's and youth development services, transportation and linkages for mental health, substance abuse and education services.

Andy OnCall® is a handyman repair service company that sends a qualified craftsman for a free estimate to homeowners needing small jobs, repairs and maintenance. Evening and weekend appointments are available and service is priced by the job, not by the hour. Andy OnCall® is dedicated to using capable, qualified craftsmen to perform services for homeowners in a timely and efficient manner. Their craftsmen have more than 10 years' experience and Andy OnCall® provides a one-year written warranty on craftsman workmanship.

How They Got Started

Westhab became interested in opening a social franchise following the successful launch of its first business, Top Chefs Soup, in 2004. Top Chefs Soup is an employment training business for homeless shelter residents producing gourmet dried-bean soup mixes with recipes from Westchester's top chefs.

Working with a McKinsey pro-bono consulting team, the leadership of Westhab chose Andy OnCall® as its next business venture because of the connection between its mission of home development and the repair and maintenance needs of existing homes. Like Top Chefs Soup, Andy OnCall® displayed the potential to create jobs for Westhab's low-income clients. Additionally, Westhab executives wanted to build a new revenue stream to use to continue to develop critically needed affordable housing in underserved communities.

It took six months of intense dialogue for Westhab and Andy OnCall® to reach a consensus on a relationship that would work for both parties. The negotiations culminated with Bob Miller, president of Westhab, signing a formal franchise agreement on behalf of the organization.

Franchise Deal

Westhab paid the standard franchise fee and royalties. Although the franchise operates from Westhab headquarters, it functions as an independent operation and currently does not contract any of Westhab's client base. The primary goal of the business is to create a profitable entity that lessens Westhab's reliance on government funding.

Unfortunately, the Westhab Andy OnCall® experienced some difficulties in its first two years of operations. The first franchise manager did not use the franchisor-provided operations manual or business recommendations. As a result, the business became reliant on the manager's personal systems and model (making it difficult for others to handle the operations) and it did not grow as predicted.

In the spring of 2007, Westhab hired a new manager who received extensive additional training from the franchisor and shifted the operations to follow Andy OnCall's® recommended model. In the words of Westhab's Vice President of Business Enterprises, Peter Roth, "It was a one-person show and that was a problem. We needed to create something that was more like a machine, so that if an individual leaves, you can fill in without the organization falling apart... Now we are a marketing and advertising company and a company that schedules the work, whereas before we were trying to be a contractor."

With the new manager and a renewed commitment to the franchisor-recommended model, Westhab Andy OnCall® began to approach breakeven. Unfortunately, just as things were starting to look up, the business was hit by broader economic currents, as declining real-estate values left homeowners with less ability and inclination to pay for home repairs. At this time, the business is still unprofitable and Westhab is re-evaluating its approach and commitment to this venture.

Challenges

Getting the right people – While there is a large labor pool of individuals possessing the technical skills required for handyman work, few of them have the communication and sales skills needed to effectively interact with customers. The Westhab Andy OnCall® reports interviewing 10 to 20 people to find two or three good craftsmen who can successfully converse with customers.

Balancing the marketing effort with its ability to build a craftsman base – In order to retain craftsmen and customers, Westhab needed to make sure it was growing its customer base and its craftsman base simultaneously. This meant providing enough work for the craftsmen to feel they could depend on Andy OnCall® for a living, and having enough craftsmen available so customers did not need to wait a long time to get work done.

Keys to Success

Utilizing existing synergies to save costs – Westhab handles numerous back-office functions for its Andy OnCall® franchise, including accounting and IT help. The Andy OnCall® manager reports that this is "very useful" and saves him – and his staff – time and money.

Targeting key customer demographics through effective advertising – In its first year of operations, the Westhab Andy OnCall® did not spend the franchisor-recommended amount on advertising. However, over the next couple of years, it tried numerous advertising venues and used the proprietary software program to better understand who its target customers were and how they were hearing about the business. The franchisee now reports that it is much "smarter" about how it uses its advertising dollars, including taking a social marketing tack that emphasizes its relationship with Westhab.

4 Getting Your Feet Wet: Is a Franchise Right for You?

BY COLEEN CURRY

Before you jump in, follow this strategy to determine if social franchising is a stream you can navigate successfully.

Developing a social franchise strategy is an investment that requires careful consideration. Social franchising, like any type of social enterprise, is not right for every organization. Before exploring this strategy there are several important pieces that need to be in place. Explore a social franchise strategy if:

- *Your organization is financially healthy.*
  Social franchising, like any small business, is a long-term investment, not a "quick fix" out of a financial crisis. Social franchising should be pursued from a position of strength. To make the necessary financial investment, your organization needs to be in a stable cash-flow position. Also, a history of strong audits will help you secure the grant or loan funds necessary for the initial investment.
- *You have experience with earned income.*
  Nonprofits that have business experience understand the benefits of the "business in a box" that franchising brings. In most cases, nonprofits with business experience have also already adopted a culture that accepts business activity and understands how it can fit into the overall organization.
- *There is an internal project champion who will lead the process.*
  A project champion will drive the analysis and key decisions that are necessary to move forward. Franchises move at the pace of business, and opportunities that are available now may not be available in six months. A project champion will help bring internal urgency so you can capture those business opportunities when it makes the most sense for the organization.

CWV's Social Franchise Strategic Process

Once you determine you have the right foundation to launch a social franchise, there is still a good deal of analysis that needs to be done before you decide to open the doors for business. Social Franchise Ventures has developed the following strategic process through our work with dozens of nonprofit clients currently developing their own social franchise strategies. The process consists of four steps to follow within your organization in order to investigate and quantify the opportunity. At the end of the first three steps, you'll reach a "go/no-go" decision, which helps you determine whether you move on or not.

Step 1: Establish Objectives & Buy-In

Starting with your organization's business goals and prioritizing those goals is the foundation of your analysis. Nonprofits are often interested in opening a business in order to develop job opportunities for underserved populations as well as to generate a strong profit. The reality is, there are often tradeoffs between mission and margin in social enterprises. A clear understanding of your realistic goals with a social franchise will help you identify the appropriate business and achieve your objectives.

Early on you also need to begin to think about how you will finance the initial franchise investment. The vast majority of franchises can be fully financed, including any build-out, franchise fees and working capital, for under $250,000.

Due to the nature of nonprofit organization management, it is crucial to begin building stakeholder buy-in for the social franchise strategy at this early stage. Since a franchise is typically outside of the core activities of your organization, you will need to begin building support across the management team and within the Board of Directors. Inviting certain board members into the planning process can be a good idea, depending on the involvement level of your board. An approach that has worked for many organizations is to continue to link the potential of the business back to the mission of your organization. The concrete link between the business results and the effect on mission will be the core of your message.

IS A KIDZART FRANCHISE RIGHT FOR MY ORGANIZATION?

Industry Overview
The Children's Education Enrichment industry offers after-school programs, in-school workshops, summer camps and birthday parties focused on a variety of subjects, such as art, dance and science. Most concepts do not require a retail space, but offer classes at school or community facilities.

Franchise Concept
KidzArt is a drawing-based fine arts program offering classes, workshops and a variety of creativity-oriented educational programs. KidzArt has developed curricula incorporating a variety of media that appeal to all ages.

Organizational Assets Needed
Consider KidzArt if your organization has one or more of the following assets: relationships with school officials, experience with children's education, access to a pool of potential instructors, strong education reputation in the parent market or available school or camp facilities.

Other Top Franchises in This Space
Abrakadoodle, Drama Kids, Kinderdance, Mad Science, Young Rembrandts

GO/NO-GO DECISION POINT

- Do I have a strong understanding of our goals – and are they realistic?
- Do I have adequate initial buy-in from the key decision makers to continue with the opportunity analysis?

Step 2: Identify Best Franchise Match

This step is the heart of the process. Here you will assess your organization's assets and develop a list of potential industries, analyze the market potential of different opportunities, reach out to franchisors to begin to cultivate relationships and develop your recommendations for moving forward.

Starting with your organization's assets will link the business back to the core organization, provide a competitive advantage and give you a strong negotiating position with a franchisor. Nonprofit leaders should ask the question, "What are the compelling strengths of my organization that I can leverage to ensure this business is a success?" A creative but honest audit of your organization's strengths usually yields multiple business opportunities. This is a point in the process where you may want to involve business experts to help drive to opportunities.

Once you have a short list of opportunities that would leverage your assets, you can investigate the relevant franchise concepts within each industry. Good sources for this are *Entrepreneur Magazine's* Franchise Zone or the International Franchise Association's website.

With the list of concepts in your target industries, determine if the franchises are available in your local market. You can do this by contacting franchisors directly. During these franchisor calls, you will also want to gauge the franchisor's willingness to consider awarding a franchise to a nonprofit organization rather than the typical individual entrepreneur. In Social Franchise Ventures' experience, the vast majority of franchisors are open to the idea, but there are still a few who are not interested. Depending on your area, you may find out that some concepts are sold out, in which case you would probably stop pursuing that industry and move to another one.

Once you have established your target industries and identified available concepts in your area, you can begin market research. This should start at a high level. Can I see this business working in my local market? What will be my competitive differentiation? Is there a market need? Who are the competitors? What is their pricing?

Assuming you have more evidence that suggests a strong opportunity, the next step is to interview franchisees in your top concepts to really understand their business, their challenges and their performance. One of the most exciting things about social franchising is that you have access to actual operators of the exact business you are considering. To reach them, you will need to contact the franchisor to get its Franchise Disclosure Document (FDD), which includes the contact information of franchisees in its system. Occasionally there will be earnings claims in the FDD, but it is strongly encouraged to test those assumptions with your own interviews.

The responses from the operators will help you build pro forma financial projections. Often the franchisees you interview will not have the additional costs of a manager in their financials, because they themselves are running the business. For a nonprofit, this is a critical position and must be included. Also, include any debt service if this is how you are planning on financing your initial investment. This pro forma financial analysis should project revenue and expenses for a minimum of three years.

IS THE MAIDS HOME SERVICE FRANCHISE RIGHT FOR MY ORGANIZATION?

Industry Overview
The Residential Cleaning industry includes general cleaning and specialty cleaning services, such as carpets and windows.

Franchise Concept
The Maids Home Service offers premium residential cleaning services. The Maids Home Service provides franchisees with detailed operations on a multi-step cleaning process that includes kitchen and window cleaning, disinfecting toilets and bathroom floors and dusting and vacuuming in all rooms.

Organizational Assets Needed
Consider The Maids Home Service if your organization has one or more of the following assets: location or reach in a high-income market with a high percentage of homeowners, logistics and transportation experience, experience with in-home services, access to a pool of reliable workers, janitorial experience or ownership of a large number of residential homes.

Other Top Franchises in This Space
The Cleaning Authority, Maid Brigade, Maid to Perfection, Merry Maids, Molly Maid,

Your final piece of analysis is to understand the initial investment required, including franchise fee, any build-out costs, starting supplies and working capital. The FDD has this estimate, but you want to assess each number from your perspective. Pulling all of this analysis together, you can make a recommendation as to whether or not you want to pursue the next step of negotiations with the franchisor.

GO/NO-GO DECISION POINT

- Does the financial business case show a compelling return on investment? Can we meet our other goals?
- Can we successfully execute in the local market, considering the industry competition, key success factors, challenges and trends?
- Are the relevant franchisors interested in continuing discussions with a nonprofit organization?

Step 3: Negotiate Franchise Agreement

The discovery process continues with meetings between the nonprofit leaders and the franchisor. Both management teams need to "get" each other. The typical franchise organization has a small staff. You need to believe in the leadership team because they will be your critical partners for the life of the agreement. Start by calling your contacts at the franchisor, attending franchisor Discovery Day and encouraging the franchisor to visit your operations.

At the end of the day, franchisors want to award franchises to franchisees who understand their business objectives and want to help achieve them. Understanding the franchisor's perspective and how your organization can help them achieve their goals will allow you to negotiate from a position of strength. Franchisors are most interested in protecting their brand, growing their system and helping franchisees succeed. If you are able to demonstrate how you can do that for them with your franchise ownership, you will be an attractive partner. Franchisors will also want to know who is accountable for the franchise and who will be running it.

When it looks like things are moving forward with negotiations, you want to begin recruiting the business manager. From more than ten years of studying social enterprises, Community Wealth Ventures believes it is most effective to hire from industry and teach the mission to a manager, rather than re-assigning someone already in your organization who does not have the industry skills. Also, if your franchise requires retail space, you want to start working with a real estate broker as soon as possible, potentially signing the lease and the franchise agreement at the same time.

Real examples of organizations using existing assets as the foundation to explore opportunities are:

- A nonprofit focused on women's issues owns street-facing real estate in a busy downtown area and is exploring retail food franchises that will generate ongoing revenue from the space.
- An educational services nonprofit is considering leveraging its strong relationships with school officials and experience working with children into a tutoring/test-prep franchise or an education enrichment franchise.
- A disabilities services provider with multi-million dollar government janitorial contracts and ownership of dozens of group homes is exploring the launch of a commercial cleaning franchise that will leverage existing industry expertise and employees.

Once the cultural connection is made, you need to make sure you have an experienced franchise attorney representing your interests. Franchise attorneys understand the Franchise Disclosure Document and the Franchise Agreement, and their support is critical to protect your nonprofit organization. The typical franchise agreement is a 10-year term and is designed for an individual, not a nonprofit organization. Consideration should be made for your organization's brand, reputation, nonprofit status, customer base and market share. While most franchisors are initially hesitant to change their standard agreement, when presented with a compelling business reason to do so, the franchisor has the authority to amend their documents.

There are several points in a typical Franchise Agreement that a nonprofit should consider negotiating, including:

- Reduction in initial or ongoing fees
- Exit strategy for the organization, with or without cause
- Additional support over the life of the franchise, including opportunity to attend owner training with each new manager hired
- Waiver of a personal guarantee for the business
- Protections related to the use of nonprofit brand or trademarks

IS A HOMEWATCH CAREGIVERS FRANCHISE RIGHT FOR MY ORGANIZATION?

Industry Overview
Non-medical services provided in the home to elderly or disabled individuals. Typical types of services include caregiver visits, companion care and personal care.

Franchise Concept
Homewatch CareGivers provide non-medical assistive services in personal residences, assisted living facilities, nursing homes and hospitals. Homewatch CareGivers provides franchisees with national partnerships and an exclusive cognitive stimulation program for patients living with Alzheimer's or dementia.

Organizational Assets Needed
Consider Homewatch CareGivers if your organization has one or more of the following assets: relationships with healthcare professionals and local community churches and nursing homes to drive referrals, experience working with in-home services, experience with the elderly market or experience with case management.

Other Leading Franchises in this Space
ComForcare, Comfort Keepers, Griswold Special Care, Home Helpers, Right at Home, Visiting Angels

GO/NO-GO DECISION POINT

- Is there a cultural match between our organization and the franchisor's?
- Have we negotiated the best agreement possible, considering our need to protect the core organization? Is our lawyer satisfied?

Step 4: Launch Your Franchise

Congratulations on making it this far! Now the real work begins. Remember, "Earned Income" needs to be earned. You will now bring the manager on board, attend franchisor training, shadow other franchisees in the system and prepare for opening day. A strong public relations campaign that leverages your innovative approach to revenue and appeals to potential customers can help with the initial marketing.

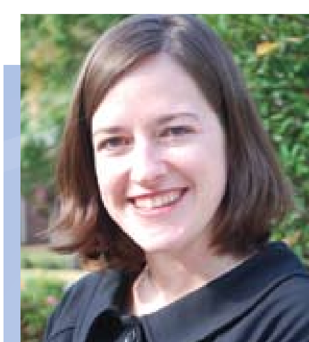
For ongoing operation, take advantage of all the support the franchisor has to offer. Listen to the franchisor and follow the operations manual. After all, this is what you're paying for. Also, comparing your unit's performance to others in the system will let you know where you need to work to improve operations and marketing.

NEGOTIATING FRANCHISE AGREEMENTS

According to Jan Gilbert, an attorney at Hayes & Boone based in Washington D.C.: Franchisors are generally free to negotiate their franchise agreements with relatively few regulatory impediments. Nonetheless, most franchisors are reluctant to do so, as they wish to protect the uniformity of their franchise systems and maintain an evenhanded approach to their franchisees. One significant exception is an agreement change crafted to address the unique characteristics and concerns of nonprofit entities. Here, where the nonprofits' objectives are consistent with those of the franchisor, we have seen greater flexibility.

Opening New Streams – Multi-unit Strategy

After you have proven your social franchise concept with one unit, there may be an opportunity to launch multiple units to achieve economies of scale and use your expertise to grow in your local region. Benefits include the opportunity to share the cost of one general manager across units, reducing waste and reliance on inventory for a certain concept because you can share across units. There is also a reduction in marketing spend. Each successive unit you open will improve your overall margins and allow you to contribute a regular, ongoing and substantial income stream to your organization.



Coleen Curry
Coleen has been a consultant with SFV and CWV since 2003, working on multiple social enterprise projects for nonprofit and corporate clients. She has helped clients research and build businesses in the fields of property management, computer software and financial services. Prior to joining CWV, Coleen was a management consultant at A.T. Kearney, serving Fortune 50 clients in the retail, technology, pharmaceutical and foodservice industries. Coleen also has nonprofit experience as a manager at Who Cares, Inc., an organization that published a magazine on best practices in the nonprofit sector.

STREAM *of* HOPE:
TRUE BETHEL BAPTIST CHURCH

Organization Backgrounds

The True Bethel Baptist Church was founded in 1961. Since Pastor Darius Pridgen began leading the church in 1994 it has experienced incredible growth. The church expanded from a congregation of 25 members to more than 3,000, requiring it to open a second location in downtown Buffalo. Throughout these changes, TBBC remained committed to being a church with a "heart for the hurting." TBBC is an active member in the community: organizing food and clothing drives, providing an emergency housing shelter and running music, drama and church-based education programs. TBBC also runs The Church Store, which sells everything from inspirational books and DVDs to wireless phone plans.

AT A GLANCE

Franchise: Subway Restaurants

Location: Buffalo, NY

Year Opened: 2004

Annual Revenue: Undisclosed

Profitability: Reached profitability within first year of operation

Mission Outcome(s): To provide valuable job-training opportunities and healthy, quick food for Buffalo residents

Legal Structure: For-profit subsidiary of profit-making arm of the church, named "Darius Pridgen Enterprises, Inc."

Offering a fresh, healthy alternative to fast-food restaurants, Subway has exploded from a single tiny sandwich shop to a globally recognized brand and the most units of any restaurant chain in the United States. Since its founding by Fred DeLuca and Dr. Peter Buck in 1965, Subway has grown to be the world's largest submarine-sandwich franchise, with more than 30,000 locations in 88 countries.

How They Got Started

The urban area where TBBC is located had not been able to attract new business development, in part because of its high crime rate. Pastor Pridgen believed that if businesses would not grow there on their own, it became the church's responsibility to stimulate economic activity in the neighborhood and to provide residents with much needed jobs. TBBC did not set out to launch a franchise, but soon realized the church's lack of business acumen could be aided by a "business in a box" model that offered brand recognition and operations training. After performing research on various franchise concepts, TBBC decided that the area's lack of fast-food options (there was only one McDonald's a few miles away) made quick-service franchises among the most desirable. Recognizing the prevalence of diabetes among community members, TBBC decided to focus on "healthy fast food" and turned to Subway.

Subway was a natural fit because of its willingness to work with franchisees in unconventional locations and its acceptance of Pridgen's priority of running the Subway as a job-training platform. Because Subway is flexible with its space requirements, the church was able to open the franchise in a small area outside of the sanctuary where the choir had practiced. This also allowed church staff to monitor the store. Because the church is located on a main street, the nontraditional location offered a high traffic count.

Franchise Deal

Before negotiating the franchise agreement, TBBC hired a team of lawyers and accountants to read the franchise agreement and assist in the negotiation. Additionally, TBBC assembled a committee of community members Pastor Pridgen relied on to create buy-in from the church community. Because the committee was unfamiliar with franchising or business practices in general, Pridgen (who had some business experience) became the liaison between the groups. TBBC paid a standard franchise fee of $15,000.

When the store opened, Pridgen tapped a nineteen-year-old local resident with one year of college experience to run the day-to-day operations (with Pridgen's oversight). Shortly thereafter, TBBC recognized the need for a more experienced manager to run the store and eventually hired a replacement. Despite the initial manager's inexperience, the first year of operations was profitable for TBBC, in part because of the media attention that came from the unique franchise arrangement.

The first-ever Subway located in a church brought news stories from around the country, including a spot on CBS Nightly News.

By the third year of operation, employee behavior was identified as a major issue for the franchise. Because of TBBC's mission to "love people and change their mindsets," inappropriate behavior and employee theft was tolerated for a longer period of time than if TBBC's motive for running a Subway were profit driven. Additionally, the Buffalo Subway was held up at gunpoint twice. Pridgen, who used to work as a Loss Prevention Manager, instituted countermeasures that included purchasing an internet-based surveillance system and hiring an employee mole. These efforts have proved reasonably effective and, in its fourth year, TBBC's Subway has performed fiscally better with a renewed emphasis on customer service.

Challenges

Inner-city crime – As one of the few businesses in the area, TBBC's Subway became a target for crime. It was hurt financially both by the robberies and the costly preventive measures it undertook. Furthermore, TBBC cited the threat of additional robberies as a difficulty in hiring and keeping a seasoned manager to run the store.

Mission over business – Pastor Pridgen states that "about half" of his employees wouldn't have a job if he was operating a traditional Subway franchise, either because of behavioral or financial considerations. Additionally, and contrary to best business practices, TBBC promotes employee turnover. Although recognizing that it is bad for business, TBBC encourages its best employees to move on to other jobs, so TBBC can focus on providing more job-training opportunities.

Keys to Success

Captive audience – Members of the congregation report they can smell the bread baking while listening to a sermon at TBBC. While no one can put a price on that kind of marketing, the majority of customers are actually not from the church. Due to its main street location and the dearth of other dining options in the area, the store gets heavy traffic from the community.

Great publicity – The first-ever Subway located in a church brought news stories from around the country, including a spot on CBS Nightly News. The store's first-year financial success can be credited to the free publicity TBBC enjoyed when the venture was created.

5 Feeding the Stream: Financing Basics

BY HEATHER PEELER

Capital is the monetary fuel that ensures the launch, operation and growth of any business, including franchises.

Lack of adequate capital is a primary reason many small businesses fail. Without a comprehensive capitalization plan, a venture's financing will be haphazard at best and insufficient at worst. Either scenario can jeopardize a social franchise's prospects for success. In order to start off on the right track, social franchisees should undertake the following tasks:

1. Realistically calculate the amount of capital needed, including timing and use of funds.
2. Identify and assess the attractiveness of different financing vehicles.

What Type?

Capital can take three forms in a business: start-up, growth and working capital. Start-up capital is the money used to invest in the launch of a business. When launching a business, you need to invest in start-up costs like space, product development and hiring new staff. You also need money that will allow you to pay all of your operating costs for the early years until the business reaches breakeven and can sustain its operations.

Growth capital is money used to grow a business. For example, capital may be used to finance an increase in staff, research and develop a new technology, pay for additional marketing expenses or purchase new office space.

Too often, social franchisees focus solely on start-up costs and forget about the working capital needed until the business breaks even.

Lastly, working capital is used to sustain a business during periods of low cash flow. These funds are used to manage shortfalls due to timing delays between when your customers pay you and when you have to pay staff and vendors.

How Much?

To determine your capital needs, you need to look at your projected-income statement and cash-flow statement. These statements spell out the projected start-up costs and working capital needed in the franchise's early years. Too often, social franchisees focus solely on the start-up costs, such as the purchase of inventory or building out of new retail space, and forget about the working capital needed until the business breaks even.

When?

When calculating the amount of capital needed, it is also important to consider the timing and use of funds. You should be able to identify when cash is actually needed, based on the business' growth and development. Keep in mind that you might not need all of your start-up funds at once. For example, consider how much cash is needed before you open your doors and how much you'll need 30, 60 or 90 days after opening. Finally, it will be helpful for you to identify how the capital will be used, as the use can impact the determination of what type of financing is most desirable. For example, a line of credit may be best for covering short-term recurring cash-flow gaps, rather than the one-time purchase of equipment.

From Where?

As a social franchisee, you have many sources to consider to finance the launch of your business. In general, capital financing comes in two forms: debt and equity. Debt financing is when an investor provides a loan and the business is committed to paying back the investor at agreed-upon terms (interest rate and time period). Debt can take the form of a bank loan or the use of credit cards. Equity financing is when an investor purchases an ownership interest in a company. An equity investor shares in the risk of launching a company and is rewarded by sharing in its profits.

Some sources of capital are only available to for-profit corporations. Others are available only to nonprofit corporations. Nonprofits cannot have equity investors because it is illegal for an individual to have an ownership stake in a nonprofit. However, nonprofits are able to accept grants and donations, which can often act like an equity investment.

WHERE CAPITAL COMES FROM

The table below illustrates different types of financing vehicles and possible sources of funds:

Type of Financing	Potential Sources for For-Profit Corporations	Potential Sources for Nonprofit Corporations
Equity	• Business Owner • Friends & Family • Angel Investors • Venture Capital Firms	• Nonprofit Parent
Debt	• Commercial Banks • Friends & Family • Government	• Nonprofit Parent • Foundations • Community Development Financial Institutions • Commercial Banks
Donations		• Foundations • Individuals • For-profit Corporations

According to a recent study by the Ewing Marion Kauffman Foundation, which profiled more than 5,000 start-up businesses since 2004, nearly 80 percent of start-up businesses relied on equity investment. However, the vast majority of equity invested came from the business owners themselves and their families. Non-family informal investors were used by 2.7 percent of the profiled small businesses and venture capitalists were used by 0.6 percent. Most of the surveyed businesses (56 percent) used debt to finance their businesses in the first year. However, 80 percent had less than $100,000 in debt.

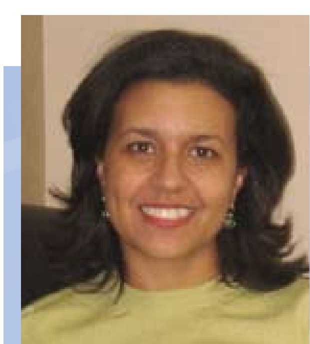
In assessing the attractiveness of different forms of financing, it is important to understand the investment terms and your business' cash flow, as well as the benefits and drawbacks of different types of financing. Debt, if used too early in a business' venture, can tie up cash flow and strap the business' operations. Equity often requires giving up some control of the business' management and/or governance.

Donations are the most common form of financing. Why would individual donors be the best sources for capital? Because they care about your mission and are interested in making investments that build nonprofit capacity. When it comes to donations, the cost of capital is low. The funds you receive from donors do not have to be returned to the donor with interest, nor do you have to give donors a cut of the social franchise's profits.

When approaching foundations and individuals for start-up capital, basic fundraising principles still apply. Start with those closest to your organization – the foundations and individuals who are longtime supporters. They will be most inclined to contribute to long-term strategies, like social franchising, that will ensure the sustainability of your organization. You also will want to have a clearly articulated case or, in investment speak, a clearly articulated return on investment (ROI). What is the benefit to the donor? This must spelled out in terms of the social impact of the franchise, such as the number of employment opportunities created or identification of how the dollars earned in profit will sustain your programs. Finally, as with other investors, you will need to convince them that you have what it takes to be successful. This can be accomplished by sharing your business plan.

In many instances, making sure your business has enough capital comes down to good cash management practices. Tactics such as negotiating favorable payment terms with vendors and customers alike and closely managing accounts payable and accounts receivable can enhance cash flow. Regularly monitoring costs and updating financial projections will help you anticipate potential problems before they happen.

Regardless of which types of financing vehicles you use, the key to adequate capitalization is thorough planning and analysis. In addition, an early start – by reaching out to stakeholders and engaging potential sources of capital from the beginning of your business planning process – will ensure you have a solid capital plan in place.



Heather Peeler
As a Managing Director at Community Wealth Ventures, Heather directs the firm's Nonprofit Services practice. Prior to joining CWV, Heather experienced a wide range of leadership and management roles at organizations, such as Innovation Network, a consulting firm serving nonprofits and foundations; Foundation News & Commentary, the flagship publication of the Council on Foundations; Small Press Distribution, a nonprofit that provides distribution services for independent literary publishers; and GenArt/SF, a nonprofit arts organization dedicated to increasing young people's participation in the visual arts.

STREAM *of* HOPE:
PLATTE RIVER INDUSTRIES

Organization Backgrounds

Platte River Industries (PRI) was established in 1987 with the mission to create market-based employment opportunities to provide individuals with disabilities the opportunity to participate productively in their community's economy. PRI creates employment that offers the employee the opportunity to meet a need in the marketplace in return for fair compensation and benefits. PRI operates several service businesses to accomplish this mission, including a very successful packaging and assembly operation.

Auntie Anne's founder, Anne Beiler, began selling hand-rolled pretzels from a concession stand at a farmers' market in 1988. She began franchising the concept in 1989 and Auntie Anne's has since expanded to more than 950 locations worldwide. Today, Auntie Anne's locations serve a variety of pretzels, dipping sauces and drinks. Stores can be found in shopping centers, airports and train stations, from the United States to Asia and Venezuela to the Middle East.

AT A GLANCE

Franchise: Auntie Anne's

Location: Denver, CO (Two airport locations, two mall locations)

Year Opened: Purchased an existing franchise in 1998, opened a second franchise in 2001 and opened the third, fourth and fifth franchises in 2005. One unit closed in early 2006 when the mall closed for renovations

Annual Revenue: Between $200,000 and $1 million per site

Profitability: Estimate $250,000 to $300,000 returned to PRI annually across four stores

Mission Outcome(s): Created 30 jobs across four stores, 50% of which are individuals with disabilities

Legal Structure: Each is a separate, wholly owned for-profit LLC under PRI

How They Got Started

PRI was operating a small popcorn concession at Denver International Airport at the time the agency started considering other options. Rocky Pop Popcorn generated approximately $150,000 per year, but was not providing consistent employment opportunities for persons with disabilities. When the Auntie Anne's stand across the concourse went up for sale, PRI initiated discussions with the owners because it saw potential for the business to provide more stable job opportunities and generate positive financial returns.

Franchise Deal

When the organization first attempted to purchase an existing Auntie Anne's franchise, the initial asking price was $850,000. After conducting its market analysis and consulting with its advisory board, the organization negotiated the final price down to $675,000 – the maximum the agency's bank and SBA would approve, given the financial analysis of the value of the business. Subsequent shops cost between $25,000 and $350,000 (including franchise fee), depending upon the size and structure of the location.

PRI is treated exactly the same as any other Auntie Anne's franchisee and is required to pay the same royalties (7%) and advertising fees (1%).

Challenges

Board negotiations – Negotiations within PRI's board were extensive and, at one point, the nonprofit became concerned that Auntie Anne's would withdraw its franchise offer because the process was taking too long.

Cash crunch – The organization experienced a brief crisis when it launched the first franchise unit, because it did not have the cash on hand to cover payroll expenses during the first 90 days of operation.

Keys to Success

Strong advisory board – At the beginning of the venture, members of the banking community, a business school dean and three business owners were recruited in conjunction with other community leaders. These individuals provided PRI with valuable insight regarding the airport marketplace and also helped the organization structure the franchise's operations so they were positioned correctly to maximize profitability.

Experienced manager – Although the organization had experience operating other business ventures, PRI realized it did not possess any airport retail experience and hired an experienced manager to oversee its Auntie Anne's units. While this individual is trained to be sensitive to the needs of the organization's clients working in the franchise, his main priority is to manage the business profitably. Hiring an experienced manager has helped to ensure the franchise units meet both financial and mission objectives.

At the beginning of the venture, PRI recruited members of the banking community, a business school dean and three business owners to provide market insights.

Careful hiring practices – The franchise units uphold the agency's philosophy that PRI exists to employ and train the disabled – at least 50% of the franchise units' employees are disabled clients of PRI. As a result, individuals who are uncomfortable working with persons with a disability cannot work for the Auntie Anne's franchise units. PRI cross trains all shift managers to be job coaches and ensures knowledge and skill in the rehabilitation field. Peer employees also all receive sensitivity training. More importantly, specific personnel policies are in place to minimize any potential negative behavior toward persons with a disability in the worksite.

Focus on business operations – The PRI social franchises look just like traditional franchises in many ways:

- PRI obtained an SBA-guaranteed loan to capitalize the franchise units. Each is incorporated as a separate for-profit limited liability company, wholly owned by the nonprofit organization.
- The organization's CEO agreed to sign a personal liability agreement with Auntie Anne's for the franchise units (PRI's board acquired insurance to cover the costs of these agreements).
- The general manager of the Auntie Anne's operation is required to manage the franchises as a profit center, and the manager's performance review and compensation are based on the business's profitability.

These decisions not only helped convince Auntie Anne's that PRI would be a good franchisee but also ensured strong ongoing financial performance. Without these positive financial results, PRI would not be able to provide valuable employment opportunities for its clients.

6 The Stream Flows Both Ways: A Franchisor's Perspective

“A socially minded franchise owner can find an invaluable resource here.”

Franchisors are increasingly open to and interested in the idea of partnership with a nonprofit organization. Many find social franchising helps enhance their brand and provides an intriguing new way to expand their systems.

Community Wealth Ventures recently spoke with Mike Isakson, President of ServiceMaster Clean and David Messenger, Vice President of ServiceMaster Clean, about their company's involvement with community organizations and social franchises.

ServiceMaster Clean is a franchise brand of The ServiceMaster Company. ServiceMaster Clean currently serves residential and commercial customers through a network of more than 4,500 franchise units. The ServiceMaster Company's other well-known brands include TruGreen, Terminix, American Home Shield, Merry Maids, Furniture Medic and AmeriSpec. Following are excerpts from that conversation.

CWV: ServiceMaster Clean has been open to working with nonprofit organizations for a long time and has launched several social franchise units already. How did you first become interested in this concept?

Mike: Over the years, many of our franchise owners have been working with local agencies. We've seen probably hundreds of owners who have and who are currently hiring in community workshop settings. These individuals, with some additional supervision, can make great housekeepers and great service workers in our organizations. Because our first corporate objective is to honor God in all we do, we strive to treat each person with dignity and respect.

Our first two corporate objectives are really the motivation and inspiration we have for getting involved with community organizations.

In some cases, our franchise owners have had to become creative where labor has become extremely tight, to draw upon a good source of labor – whether it's the developmentally disabled, emotionally disabled or an individual coming out of a personal crisis. A socially minded franchise owner can find an invaluable resource here.

Dave: Our second corporate objective is to help people develop. That's not just people like Mike and me, that's people of all types and all mental and physical capabilities. I think tying into our first two corporate objectives are really the motivation and inspiration we have for getting involved with community organizations.

CWV: Who are some existing nonprofit franchisees you're working with? How did they get started?

Dave: The Vice President of Easter Seals in Waterford, Connecticut is a relative of a ServiceMaster Clean franchise owner. Easter Seals launched a ServiceMaster Clean franchise in 2007. Platte River Industries of Denver, Colorado launched a ServiceMaster Clean franchise in 2008. They already understood the franchise model through their work with Auntie Anne's.

It's important to have the right fit with the nonprofit, and that fit is objectives, goals and culture.

CWV: What do you hope to see with a social franchise strategy? Is there a percentage of your system that you could see being run by nonprofit franchisees?

Dave: I don't think we've quantified it at this time. I think it is a bit too early to know what this could bring to us; but certainly if we could do two to four a year, that really makes sense. I think more important is to have the right fit with the nonprofit, and that fit is objectives, goals, culture and to make sure, instead of a quantity number, it's the quality and just making sure that we do have the right fit.

CWV: Do you see it potentially being something that, assuming the quality is there and you're making good choices with the franchisees, could be an even broader strategy for ServiceMaster Clean?

Dave: I think so, especially with our janitorial business. Because we employ a lot of people in those businesses at the franchise level, I think we've got some great opportunities to provide meaningful work for people with disabilities. I think it's something that could fit into a lot of markets. This certainly can be part of our strategy, going ahead.

CWV: How do other franchises in the system view bringing in a different type of franchisee, a nonprofit organization?

Mike: I think that, because of our objectives and who we are, there would be general acceptance and support. They will depend on us at the home office to ensure that the franchisee is meeting the responsibilities in terms of performance and customer care and is supporting our brand. We've got to do that right. If we don't get that right, there will be a problem. We can't compromise or alter the brand for social franchising. Because of the way that Easter Seals, Platte River and some of the others are going after this, we think it will not be an issue. All of that said, I think there will be good acceptance, but there will be accountability for each nonprofit group, same as any other franchisee.

CWV: Are there any additional types of support that you need to give to nonprofit organizations? Anything different in the way you bring them on board?

Mike: I think there are some different motivators, if you will. An entrepreneur has debt and equity opportunity and risk in play. Some of the nonprofits, the managers of these divisions or these groups are salaried individuals, perhaps with some bonus opportunities. A lot of our incentives today are very obvious to franchise owners. If they grow their business, maintain their gross margins, control their overhead, they can see increased personal return via the revenue and profit in the organization they build, and actually in what they take home in compensation. That's one difference we have to recognize. Perhaps the motivation set is a little different.

Secondly, it's very important that we don't mix the mission of nonprofits with management of the franchise. You've got to make sure you understand there are some management principles that just absolutely, no matter what you're doing, have to be in the business.

CWV: How do you assess the nonprofit organization's ability to succeed in a franchise?

Mike: Growth. Just flat out, are they bigger today than they were yesterday? The divisional profitability, or looking at the balance sheet and customer satisfaction. It's no different than any other business.

Dave: That's the thing. With both Easter Seals and Platte River, they are looking for for-profit operations inside a nonprofit. They see this as part of their funding. That certainly struck a chord with us, because we're used to dealing with entrepreneurs who obviously want to make a profit and build equity.

CWV: There are only about 100 social franchises in the United States today. ServiceMaster Clean is an early adopter. Do you see potential for other franchise companies and nonprofits to work together?

I think a lot of franchise owners have a great deal of heart and are very thankful for what they've been given. People are blown away by the friendliness of people in franchising.

Mike: I certainly think there's some opportunities for other franchise owners to be involved with nonprofits. Why it works in franchising is, by and large, most franchise owners today are what are considered small-business people. They're businesses that are considered under the $20 million mark. If you look at the philanthropic levels of small business and middle-income Americans, these are the people that give and have real care and concern for their communities. I think a lot of franchise owners have a great deal of heart and are very thankful for what they've been given. They believe that if you've been given much, you need to give much back.

Dave: That's a great comment. Every time I go to a franchise event, I always see people who are new there, and they say, "Boy, this is just such a friendly group. They're so open and sharing." People are blown away by the friendliness of people in franchising, and I think it's terrific. People make the business.

CWV: What advice would you give to other franchise owners who are thinking about working with nonprofit organizations like this?

Mike: It's all about the value proposition that they bring to a customer buying the services or the products. Just ensure that the delivery system that is out there is matched to the ability and the skill set of those individuals that have the means, that have the organization, that are looking at the social needs of these individuals. If that cannot be modified or managed or explained in a way that meets the ultimate customer's needs, don't do it. That's my number one thing.

Number two is that they look at the financial commitment. It is a long-term commitment. Thirdly, that you look at who is going to run that division or that part of the organization. Make sure they're qualified and that they're committed to running an active, full-on business.

Dave: I think, from the franchise owner point of view, make sure that it is the right fit for them, both culturally and organizationally, that they are very comfortable with each other and that this is the right type of business for them to be in together.

CWV: As an organization, have you considered putting together a formal program that would help your existing franchisees utilize community organizations for employment? Or, how to recruit nonprofit organizations as franchisees in open territories?

Mike: That's certainly something we've been looking at. As a formalized program, it doesn't exist yet, but it might be a good idea. We have an award that's called the Ken Hansen Stewardship Award. The Hansen Award is specifically designed for those individuals who, through their business, either do things for the community or for individuals or groups that demonstrate this extra care and compassion.

STREAM *of* HOPE:

THE FONTANA REHABILITATION WORKSHOP

Organization Backgrounds

The Fontana Rehabilitation Workshop, Inc. (FRW) was founded in 1964 to meet the needs of individuals with developmental disabilities. Primarily, the workshop was established to provide continued program activities for the growing number of "trainable mentally retarded" students graduating from the Slover Special School in Fontana and from special-education classes throughout the Fontana School District. In 1965, the workshop separated from the school district and became independent. The organization presently serves more than 100 individuals with disabilities on a daily basis and trains clients to do subcontracted work.

FRW contracts with the federal government to package and assemble military badges. Additionally, FRW provides other fulfillment jobs, such as assembling and packaging sporting goods, pet products and other consumer goods. Clients are also trained in grounds and janitorial maintenance, and work on both residential and commercial accounts. FRW also serves state and county agencies such as CalTrans.

AIM Mail Centers are complete business service centers, offering a wide array of products and services for large and small businesses, plus general consumers. This includes shipping services with UPS, FedEx and the U.S. Postal Service. They provide packaging, stamps, fax and notary-public services, mailbox rentals, photocopies, office supplies and more. There are more than 115 AIM Mail Centers nationwide.

AT A GLANCE

Franchise: AIM Mail Centers

Location: Rancho Cucamonga, CA

Year Opened: March 2000

Annual Revenue: $260,000 in gross sales in 2007

Profitability: Broke even in year two; profitable by year three

Mission Outcome(s): To provide training and employment opportunities for consumers and increase community awareness of Fontana and its mission

Legal Structure: For-profit subsidiary

How They Got Started

FRW's decision to enter the social franchise arena was driven by two factors: its mission and its funding situation. FRW focuses on providing community employment for people with disabilities, and was interested in developing new program services and forms of employment for its clients. Thus, the decision to enter franchising was driven by a desire to better fulfill its social mission. However, in the late 1990s, California government reined in spending to concentrate funds in other budget areas. This impending loss of state funding also created the need to diversify revenue streams. Initially, FRW had looked into independently developing new employment opportunities through its existing departmental services, but found it difficult to convince community employers to increase the number of FRW's clients they were willing to hire.

FRW wanted to run a business close to its corporate headquarters with a relatively low start-up cost. It had an existing workshop for volume packaging, so the directors attended a franchise expo and started exploring options in the related fields of mailing and printing. The AIM Corporation offered a money-back guarantee if the franchise did not work, and an existing AIM mail store was for sale. FRW was able to purchase the store for a relatively low cost and hire a manager with previous experience operating a Mail Boxes Etc. location. AIM had never worked with a nonprofit organization previously, but felt that the FRW could make a good franchisee because it had experience in a related field.

Franchise Deal

FRW purchased an existing AIM Mail Center that had been closed and turned over to the franchisor. Because it did not have to deal with build-out, buying the existing store was cheaper than building and starting its own store. FRW currently pays the standard 8% royalties to AIM Mail Centers. It has six employees, three of whom were placed at the center through FRW.

The Rancho Cucamonga AIM Mail Center does not advertise that it is part of FRW, in part due to AIM's relatively stringent advertising content rules. The Rancho Cucamonga AIM Mail Center reports that it advertises like any other AIM Mail Center and that its strong business is a result of its superior customer service. It further confirmed that the surrounding community has embraced the three workshop-sourced employees and that they have truly been an asset to the center.

The founding of FRW's Rancho Cucamonga AIM Mail Center paved the way for other nonprofit organizations to become AIM Mail Center franchisees. AIM Mail Centers currently has two nonprofit franchisees besides FRW: Elwyn, Inc. in Huntington Beach, California and CenterForce in Lakewood, Virginia.

Challenges

Revenue does not equal profit – FRW initially struggled with the concept that simply because the mail center was generating revenue, this money was not available to be spent on programming, because all of the costs of the business had to be covered. While it is exciting to see large top-line revenue from any business, it is important for nonprofit leaders to remember that only net profits can actually be used as unrestricted revenue to support the mission of their organization.

Developing vendor relationships – Franchisor-recommended vendors don't necessarily offer franchisees the best prices on all items. It took FRW a while to realize it was cheaper to purchase paper from Costco than from its original vendor.

Keys to Success

Discuss mission objectives up front – Nonprofits need to communicate to the franchisors early in the process if the organization is looking to use the franchise unit as a job-training platform, as a catalyst for community development or for another social purpose. This disclosure is particularly important, given the impact mission objectives can have on financial performance. From the beginning, FRW made it clear to AIM Mail Centers that the organization was looking to use the franchise unit as a job-training platform for its disabled clients. Only after the franchisor accepted this condition did the organization proceed to the negotiations phase of the franchise process.

Negotiate terms of franchise agreement – Some organizations assume that, because of their nonprofit status, franchisors will automatically give them the best deal available. FRW negotiated with AIM Mail Centers for several weeks before signing the franchise agreement. Issues discussed included the cost of acquiring the franchise, the responsibilities of the franchisor for refurbishing the site location and the use of clients within the franchise unit. As FRW's Executive Director, Joseph Mitchell, stated, "Be as strong in your business as you are in your mission, or else you'll be out of business."

7 A Different Kind of Stream

Social Franchise Ventures is often asked how a nonprofit organization that has developed a compelling program or service delivery system can expand its reach by franchising the concept. The decision to franchise, as opposed to license or to expand directly, must be considered carefully. We have asked for permission from Mark Siebert to reprint the article below, which provides insights into developing a franchise system.

Should I Franchise My Business?

Originally published in Successful Franchising
By Mark C. Siebert, Chief Executive Officer, The iFranchise Group

Have a better mousetrap and scared to death that the world actually is beating a path to your door? People walking through your operation with notepads and cameras? Trouble sleeping at night wondering who will knock off your operation first? Certain that yours is the next Ray Kroc story, if only you could get the capital? Tired of reading about companies and thinking, "I have a better franchise concept than that company."?

Maybe you, too, should consider franchising.

Why Franchise?

In general, companies franchise for one of three reasons: time, people or money.

The primary barrier to expansion faced by today's businessperson is capital. And franchising allows companies to expand without the risk of debt or the cost of equity. Since the franchisee provides the initial investment at the unit level, franchising allows for expansion with minimal capital. Moreover, since it is the franchisee, and not the franchisor, who signs leases and commits to various service contracts, franchising also allows for expansion with virtually no contingent liability, thus greatly reducing the risk to the franchisor.

Another barrier to expansion facing many of today's businesses is finding and retaining good unit managers. All too often, a business owner spends months looking for and training a new manager, only to see that manager leave – or worse yet, hired away by a competitor.

Franchising allows the business owner to overcome many of these problems by substituting a motivated franchisee for the unit manager. Interestingly enough, since the franchisee has both an investment in the unit and a stake in the profits, unit performance will often improve. And since a franchisor's income is based on the franchisee's gross sales, and not profitability, monitoring unit level expenses becomes significantly less cumbersome.

Finally, opening a unit takes time. Hunt for sites. Negotiate leases. Arrange for design and build-out. Secure financing. Hire and train staff. Purchase equipment and inventory. The end result is that the number of units you can open in any given period of time is limited.

For companies with too little time (or too little staff), franchising is often the fastest way to grow. That's because it is the franchisee that performs most of these tasks. The franchisor provides the guidance, of course, and the franchisee does the legwork. Thus, franchising not only allows the franchisor financial leverage, but it allows him to leverage his resources as well.

The Process of Franchising

When a company makes a decision to franchise, it must first develop a sound plan for expansion. The plan must take into consideration the numerous issues confronting a new franchisor: speed of growth, territorial development, support services, staffing, and fee structure, to name several of the most important issues. Larger companies need to address more complex issues such as channel conflict, anti-trust and resource-allocation issues. And obviously, this entire plan needs to be subjected to rigorous financial analysis and scrutiny to fine tune the strategy for growth.

Once this plan is in place, the franchisor needs the proper legal documentation. At a minimum, the franchisor will need a franchise contract, an offering circular (as required under FTC Rule 436) and, depending on where franchises are being sold, state registrations. There are literally hundreds of different business issues that must be addressed in a good franchise agreement, and the decisions made regarding these issues will ultimately dictate the franchisor's success.

Quality control for a new franchisor involves the development of highly developed systems. Generally, this translates into the development of an operations manual. This manual must contain not only the systems used by the business, but also the checklists, policies, procedures and tactics that will allow these systems to be uniformly enforced. Moreover, operations manuals must be careful to avoid the creation of an agency and must also address issues that could create claims of negligence if the franchisor is to maintain an effective shield from consumer liability.

BUT IS MY BUSINESS "FRANCHISABLE?"

Franchising is a relatively flexible format, and just about any type of business can be franchised, provided it meets some basic characteristics:

- It needs to be credible. Does it have experienced management? A track record over time? Is the concept proven? Has it achieved good local press or public acclaim?
- It needs to be unique. Is it adequately differentiated from competitors? Is it marketable as a business opportunity? Does it have a sustainable competitive advantage?
- It needs to be teachable. Are the systems in place? Are operating procedures documented? Could someone learn to operate the business in three months or less?
- It needs to provide an adequate return. Not just profitability. If a business cannot generate a 15% - 20% return on investment after deducting a royalty (typically between 4% and 8%), it is going to have difficulty keeping franchisees happy.

If your business meets these criteria, then it may be a good candidate for franchising.

Finally, the new franchisor must develop the ability to market and sell franchises. That requires knowledge of how to attract the prospective buyer and the necessary materials (brochures, mini-brochures, videotapes, DVDs, etc.) that will help make the sale. Moreover, since the franchise sales process is highly regulated, the franchisor needs to be educated in proper sales, disclosure and compliance techniques.

Every new franchisor quickly learns that when they turned to franchising they entered a completely different business. Regardless of how the franchisee makes money, the franchisor has two roles: selling franchises and servicing franchisees. And of the two, ensuring the success of the franchisee is the more important.

Every new franchisor quickly learns that when they turned to franchising they entered a completely different business.

Properly structured, franchising can allow small companies to more effectively compete with much larger competitors. It can also allow large companies to gain the advantages of highly motivated unit management while reducing overhead. As such, franchising is an option that more and more companies should explore.

The key to success in franchising is successful franchisees.
Without successful franchisees, no franchise system will last. But if you can put the interests of your franchisee first, those same franchisees might help you become the next McDonald's.

STREAM *of* HOPE:

AHRC

Note: The following case study does not technically include a franchise company, but rather a "business opportunity" organization that uses a model similar to that of franchising. Due to the franchise-like nature of this organization's relationships with nonprofits, we felt it would be of interest to readers of this publication.

Organization Backgrounds

Fifty-nine years ago, a small group of parents joined together and started AHRC to obtain services for their children with developmental or intellectual disabilities. The organization now serves more than 11,000 individuals. The aim of AHRC's work has been to offer disabled individuals day-to-day living that is as rich, absorbing and worthwhile as possible, with an emphasis on helping individuals live up to their maximum potential in the community. In addition to its social services, AHRC also offers a variety of business services in order to provide employment and job training for its clients.

AT A GLANCE

Franchise: Cartridge King

Location: New York, NY

Year Opened: 2005

Profitability: 10% margin in 2007, expected to increase significantly as it moves from purchasing pre-made cartridges to building them in-house

Mission Outcome(s): To provide nineteen jobs with a combined disabled and non-disabled staff

Legal Structure: AHRC Cartridge King operates as a program of AHRC and retains nonprofit tax status

Cartridge King is a unique corporation, founded with the express purpose of creating non-mainstream jobs for immigrants and people with disabilities. It is primarily a training company that teaches nonprofit organizations the important and transferable skills of how to make, market and sell a product. Chip Beziat, founder of Cartridge King, chose cartridges as the "product of choice" because he saw that laser printer cartridge recycling was an up-and-coming environmentally friendly business that could be licensed to nonprofit organizations around the country, generating revenue for the organizations, and jobs for the underemployed populations they served.

How They Got Started

Previous to its Cartridge King franchise, AHRC had worked with a private commercial cartridge-recycling firm. This firm provided limited jobs for AHRC clients to "sort empties," which were then sold to remanufacturers. In 2004 AHRC hired an Associate Director of Administration and Finance, with previous experience as the Executive Director of a similar imaging and recycling facility in Connecticut (and another Cartridge King affiliate).

To enhance AHRC's training services, the Director recommended AHRC partner with Cartridge King instead of the private recycling firm because the Cartridge King business model trained and employed workers to completely remanufacture cartridges, rather than to simply sort empties. This more challenging work would create highly transferable job skills and provide a higher rate of pay.

Franchise Deal

Cartridge King operates under a "business opportunity model" and works solely with nonprofit organizations, primarily those organizations which focus on employment for disabled, impoverished and disenfranchised individuals. The total initial fee of $13,000 has not changed since Cartridge King's inception and includes:

on-site training, technical assistance, training materials for supervisors (updated when new Cartridge King products are released), marketing materials, sales tools and the equipment necessary to employ two workers. AHRC and other Cartridge King business partners purchase supplies through Cartridge King, but do not pay an ongoing royalty or any other fees.

AHRC Cartridge King grew conservatively in its early years, due to mission focus and the limited resources allocated to it. Prior to July 2008, it primarily purchased and resold pre-made cartridges, resulting in a small but consistent margin. Since then, it learned how to manufacture more of its biggest-selling cartridges, which resulted in larger margins and allowed it to expand to an additional production site and create more jobs for disabled individuals. A recently created partnership with another Cartridge King business helped AHRC gain "preferred provider" status with New York State, opening the door to pursue contracts from state agencies in close proximity to its production sites, potentially increasing revenue greatly.

Challenges

Lacking a strong sales force – AHRC's Vocational Services briefly added a marketing and sales representative who closed 10 Cartridge King contracts in her first year, generating more than $40,000 in additional revenue. Unfortunately, in 2008, severe budgetary pressures forced AHRC to lay off the salesperson. As a result, the majority of contracts are generated through AHRC's business contacts and referrals from existing customers.

Non-traditional work days – Many disabled persons do not work an eight-hour day, or are often unavailable for scheduled shifts because of medical and therapeutic appointments.

Keys to Success

Location – AHRC initially operated the Cartridge King out of its main office, and has since expanded to an additional production site in Queens. Its central location allows it to easily recruit nearby businesses as customers.

Socially concerned business – AHRC believes that many customers chose its business because it serves and employs disabled individuals. It also acknowledges that the environmental and social aspects of the business, separate from AHRC's own mission, appeal to potential customers.

Straightforward business and access to labor pool – As a nonprofit that already provides vocational training, AHRC had access to a large labor pool to staff its business. With Cartridge King's relatively simple business model and requirements for low-skill labor, it has not been difficult for AHRC to locate and train employees for the franchise. The recent shift from using pre-built cartridges to manufacturing them in house has added to the complexity, but also created more job opportunities and improved profit margins.

Using existing organizational capacity can defray costs of operating a franchise – By utilizing the strength of its accounting department and warehousing, AHRC did not have to hire additional staff to deal with the financials and materials-storage concerns of the Cartridge King operations.

Resources

General Franchise Information

International Franchise Association (www.franchise.org)
The International Franchise Association is the world's oldest and largest membership organization representing the franchise community. The IFA website provides a broad listing of franchise opportunities, educational resources and other franchise-related information.

SBA Franchise Hotlist (www.sba.gov/hotlist/franchise.html)
The SBA Franchise Hotlist provides referrals to numerous other franchise resources.

Ben & Jerry's PartnerShop Program (www.benjerry.com/scoop_shops/partnershops)
Information on Ben & Jerry's Scoop Shop program that offered franchises to nonprofit organizations.

Researching a Franchise Concept

***Entrepreneur Magazine* Franchise Zone (www.entrepreneur.com/franzone)**
Entrepreneur Magazine provides an annual ranking of various franchises as well as help and how to links.

California Electronic Access to Securities Information – Cal-EASI (http://134.186.208.228/caleasi/Pub/Exsearch.htm)
The California Department of Corporations hosts a database containing Franchise Disclosure Documents for the franchises registered for sale in the state of California.

Franchise Publications

***Franchise Times* (www.franchisetimes.com)**
Franchise Times is the leading publication on the franchise industry.

IFA SmartBrief (www.smartbrief.com/ifa)
The IFA SmartBrief is a free, 3x/week email news briefing on issues related to franchising and small businesses.

Legal and Financing

Federal Trade Commission (http://www.ftc.gov/bcp/franchise/netfran.shtm)
The Federal Trade Commission regulates the franchise industry and provides information and guidance related to franchising.

The Franchise Registry (www.franchiseregistry.com)
A registry of franchises that are eligible for expedited loan processing through the SBA.

American Bar Association Forum on Franchising (www.abanet.org/forums/franchising/home.html)
The mission of the Forum on Franchising is to be the preeminent forum for the study and discussion of the legal aspects of franchising. The ABA is a source for franchise lawyer referrals.

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INSTRUCTOR

Benjamin C. Litalien is a Certified Franchise Executive and has almost two decades of franchise management experience with such notable companies as ExxonMobil and Frullati Café & Bakery. Ben is also the Academic Advisor for Franchise and Entrepreneurial Programs and he developed the Franchise Management Curriculum. Ben currently serves as Strategic Franchise Advisor for Social Franchise Ventures, LLC (SFV) a Washington, D.C. based consulting firm that exclusively represents nonprofit organizations seeking to enter the franchise community. He is also founder and principal of Franchise*Well*, a specialized consulting practice in franchising. He holds a Bachelor degree in Business Administration from Abilene Christian University in Abilene, Texas and an Executive MBA degree from the University of Houston in Houston, Texas.

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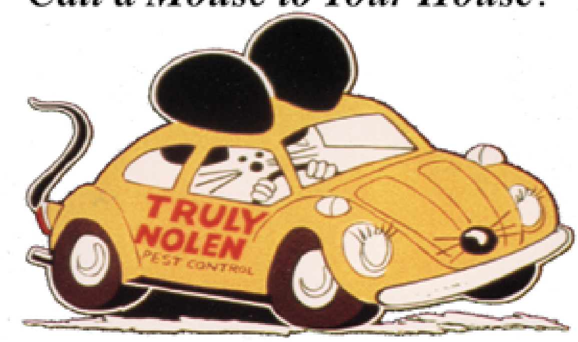

Truly Nolen offers a franchise based upon a system of personal reliance. Our trademarked Mouse Car symbolizes our business system.

We offer a unique franchise opportunity for non profits to leverage existing assets for generating revenue and to benefit their clients.

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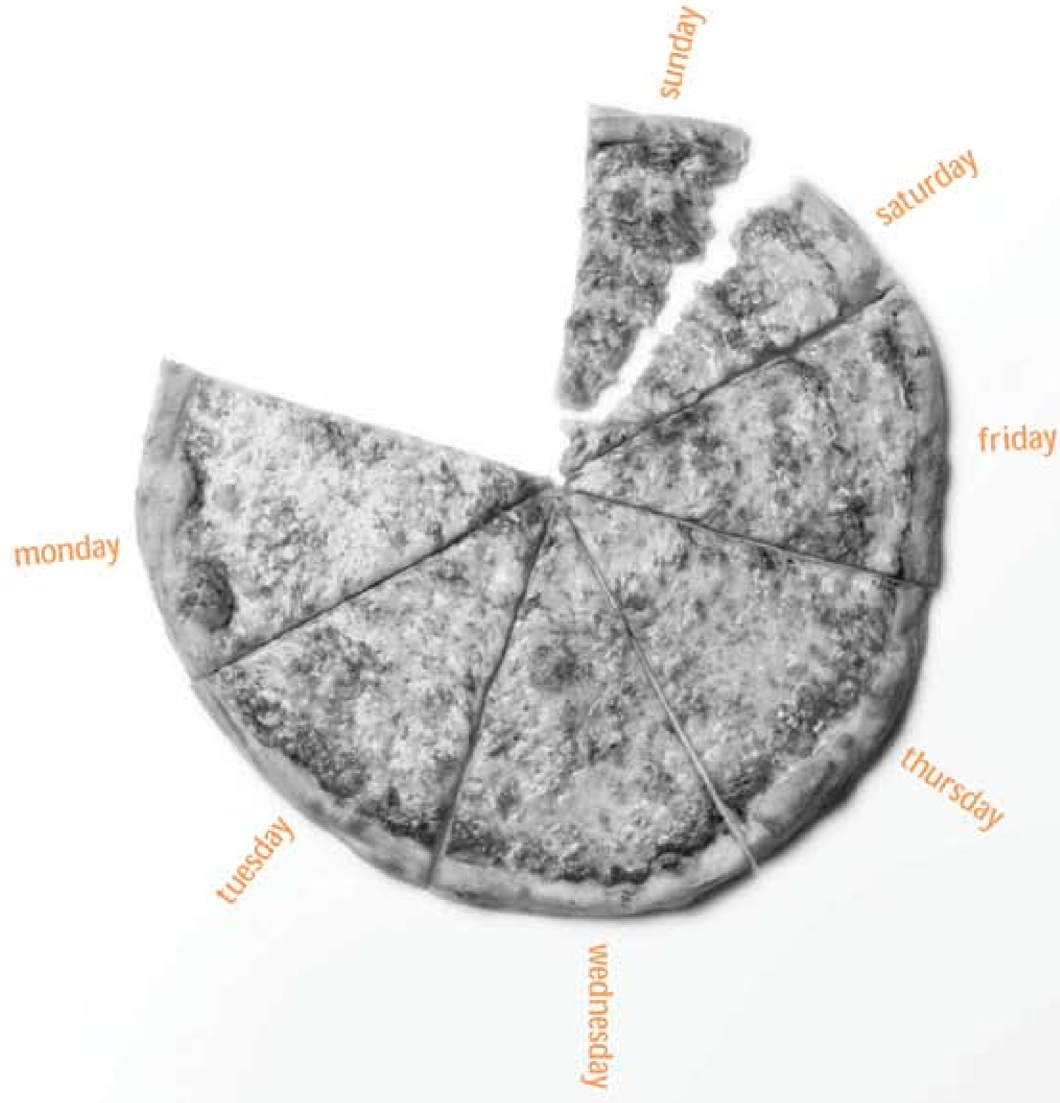

The face of hunger in America is too often the face of a kid. It's easy to miss. You don't see how her dad is stretching money to the point where a pizza has to last a week. Or that she's not getting the nutrition she needs to grow. An invisible hunger affects over 12 million kids right here in the world's wealthiest nation. You can help end this disgrace. See how at **strength.org**

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TODAY IN AMERICA, MILLIONS OF NONPROFITS ARE SUFFERING FROM BRAND DEFICIENCY.

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Even some of the most well-meaning, well-funded organizations won't harness the full potential of their single most powerful asset. It can be tragic considering a strong brand can increase an organization's value, inspire a workforce, magnify the reach and impact of marketing and bring clarity to a mission. But something can be done about it. We can help you discover, clarify, express and live your brand. And, in the process, create more compelling and effective communications. In fact, we've recently helped turn the tide for a number of regional and national nonprofits and public awareness initiatives. To see some of this work, visit www.durhamgroup.com. And to talk to us about your challenges, call Michelle Leibovitz at 860-677-8885.

BRAND ▸ STRATEGY ▸ ADVERTISING | PR | MEDIA | INTERACTIVE | GOV. AFFAIRS

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About Community Wealth Ventures

Community Wealth Ventures is a consulting firm that emboldens and equips leaders to innovate, grow and sustain organizations that build a better world.

Social change organizations have effective solutions to society's most challenging problems. But they don't always have the resources needed to scale their impact. Community Wealth Ventures helps these organizations improve business and organizational strategies and embark on new entrepreneurial approaches to increasing financial self-sufficiency and their capacity to execute their mission.

CWV specifically works with nonprofits to identify their assets, assess opportunities and build appropriate ventures, including business enterprises, partnerships and licensing agreements. CWV also tackles challenging strategic issues, such as growth and scalability, sustainability and organizational business plans.

Since its launch in 1997, CWV has worked with more than 200 nonprofit organizations. It has become the nation's leading consulting firm applying entrepreneurial strategies to nonprofit missions. In fact, CWV is wholly owned by Share Our Strength, a leading anti-hunger organization, and profits generated from CWV's consulting services go back to support Share Our Strength's anti-hunger mission. In this sense, CWV is an example of just what can be accomplished.

Services and Special Initiatives

All of CWV's areas of practice emphasize strategies that leverage market forces and the use of extensive data and analysis to inform decision making. CWV's services include:

- Business Plans
- Market Analysis
- Growth Strategies
- Grantmaker Strategies
- Feasibility Assessments
- Earned Income Ventures
- Social Franchise Consulting
- Group Consulting & Training

Community Wealth Regional Initiative

The Regional Initiative is designed as a multi-year endeavor that seeks to develop a cohort of social enterprise market leaders in a region and nurture local infrastructure to support social enterprise development.

Social Franchise Ventures

Social Franchise Ventures is a special initiative of CWV dedicated to helping qualified nonprofit organizations operate franchise businesses to advance social change. SFV helps organizations develop strategic relationships with appropriate franchise partners, negotiate favorable agreements and launch and grow strong social franchise businesses.

YOU'RE OUT TO

MAKE A BETTER WORLD.

WE'RE OUT TO

MAKE A BETTER YOU.

You have the passion, the people, the programs. You have the tools in place to not merely sustain, but grow your mission. Sometimes it just takes an outside force to help you make more of them.

As the nation's foremost consultant to nonprofits, we understand your challenges. And as a thought leader in the field, we know some practical yet innovative ways to cultivate solutions. We do it by rolling up our sleeves, getting up close and finding new approaches to building wealth and opportunity from within, instead of relying solely on support from traditional sources. You have what it takes to address our world's most pressing social challenges. We have what it takes to make you even better at it.

To learn more, call 202-478-6570 or visit CommunityWealth.com

Business Plans
Market Analysis
Growth Strategies
Grantmaker Strategies
Feasibility Assessments
Earned Income Ventures
Social Franchise Consulting
Group Consulting & Training

Community Wealth Ventures, Inc.

Hope for sustainability. Hope for self-reliance. Hope for growth. And, most importantly, hope for the people and causes that need hope most of all.

Streams of Hope examines the groundbreaking concept of social franchising and its potential to offer nonprofit organizations an unrestricted flow of funding to support mission activities.

Authored and compiled by Community Wealth Ventures, the nation's leading consulting firm to nonprofits, this publication is a must read for nonprofit organizations seeking new, more-reliable funding sources. It serves as both an introduction to social franchising and a handbook for navigating this exciting new income stream.

"Social Franchise Ventures is absolutely excellent. The level of expertise exceeds that of the traditional consultants. They were very focused. SFV has the expertise and the practical experience that we needed."

— MIKE HEPLER, CEO, BOYS & GIRLS CLUB OF WESTERN PA

Community Wealth Ventures, Inc.

and

the Social Franchise Ventures Initiative