Steven P. Watten
Strasburger & Price, LLP
2801 Network Boulevard
Suite 600
Frisco, TX 75034
(469) 287-3939
Steve.Watten@strasburger.com
vCard
Bio
Website

LinkedIn
Twitter
Blog
JD Supra

Lauren T. Becker
lauren.becker@strasburger.com

Finding Financing in This Economy

The threshold issue franchisees face in entering the franchise market, and often the first question being asked of our franchise legal panels this summer, is "How can I get financing?" The franchise industry has been directly affected by the "perfect storm" that began two years ago (the mortgage crisis, sky-rocketing fuel prices, stock market and job losses) and is still raging. As a result of these crises, commodity costs have risen, consumer spending has dropped, and significantly, business lending has been sharply curtailed – and start-up loan facilities have become all but extinct.

From the New York Times in June 2010: "The big national companies that dominated franchise lending before the 2008 collapse have stopped or reduced financing. The remaining lenders – often local banks – have been more restrictive in their credit underwriting, and they have been demanding more collateral (like home equity), more cash liquidity, more experience in the industry and outside sources of income...." The article predicts a $3.4 billion credit shortfall for the rest of 2010 and 2011, between the $10.1 billion that will be requested by the franchise industry and the $6.7 billion banks are expected to lend.

All realize how difficult the situation becomes when money tightens and growing demand for financing has to chase loss and less money available for loan. Franchisees obviously need financing, and franchisors need their franchisees to find financing if their systems are to grow, or even survive. Franchisees are having to adjust to the tighter requirements of the lending sources that still offer franchise financing, by liquidating some positions to keep more cash, diversifying their income streams, and sometimes postponing buying their franchises and keeping at their jobs for awhile to save cash and gain experience. For their part, some astute franchisors are actively trying to reduce franchise costs such as up-front fees, capital investments and ongoing royalty rates. Others are reducing franchisees' capital costs by creating their own equipment leasing programs. Others help franchisees find capital by helping them package their own Small Business Administration loan applications, and in some cases even co-signing the loans.

Difficult though it will be, it seems to us that the coming six business quarters may be a remarkable opportunity for the stronger (and/or more creative) franchise systems to attract the most desirable franchisees, and vice-versa. Shrewd franchisor's will expand their offerings to include assistance as described. In addition, wise franchisors will intensify studies of their systems for insights not only into what works, but into locations, demographics, products or services, and operational practices that do not work in their systems. Over time, this practice will reduce the attrition rate among system franchisees. The franchisor who keeps its attrition rate down, especially in hard times, will find itself that much more attractive to the most desirable franchisees, and its franchisees more attractive to prospective lenders.

While the approval process has lengthened and become more stringent, access to traditional bank financing is available and a viable option for obtaining franchise loans for certain franchisee groups. Conventional bank loans are more likely for well-capitalized borrowers, like multi-unit franchisees, and customers who have continuing relationships with their banks - another indicator that the franchise industry will ultimately benefit from the lending crisis because systems' better capitalized and more experienced franchisees will continue to more readily obtain credit. Under-capitalized unit operators or investors in new franchise concepts will continue to face challenges in finding traditional financing. These groups can look to franchisors for the assistance discussed above and can seek out financing from local banks and non-bank lenders like equipment financing companies. SBA lending remains, for now, in a state of flux.

[Reprinted with permission of Lauren Becker, author]