

REPORT HIGHLIGHTS

of the

2002 Financial Benchmarking Study



**BUSINESS
RESOURCE
SERVICES**



**IFA EDUCATIONAL
FOUNDATION**



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Washington, DC

Project Director
Barbara Carper, CPA
Business Resource Services

FOREWORD

Business Resource Services, or BRS, specializes in financial management education for the owners and managers of independent businesses. BRS conducts financial benchmark studies of trade associations and franchise organizations to add specific and relevant information to their educational programs. The BRS team includes leading speakers and consultants in the area of small business finance, with backgrounds in banking, finance, accounting, and business start-ups. BRS' clients include some of the world's largest and most successful associations, banking institutions and corporations, including the American Rental Association, Bank of America, Anheuser-Busch, Harley Davidson and John Deere.

The International Franchise Association has partnered with BRS to develop a *comprehensive financial management process* to strengthen members' financial decision-making resources and to improve their profits and cash flow. The process includes:

- 1) Providing education for members in financial analysis, profit planning, capital needs forecasting and strategic business planning
- 2) Identifying key financial performance issues effecting profitability and cash flow
- 3) Establishing benchmarks for measuring future improvements in financial performance
- 4) Consistently applying a process of performance measurement

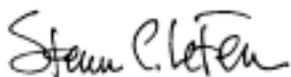
Our process begins by measuring the financial performance of a group of companies within a network – in this case, 58 International Franchise Association members. From the information gathered we've written the 2002 Financial Benchmarking Study. The study describes key issues to manage, and presents the benchmarks for measuring them. It also identifies the successes of the participating members and explores the variety of ways they achieved success.

Study participants will receive the full report as a thank-you for participating. All other members receive this report, the abbreviated Report Highlights.

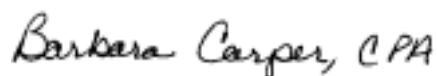
Information is only valuable when it is understood and used. When benchmarking is combined with education for understanding, tools for implementation and discipline, success will follow. To help members use the study results to make positive change in their companies, we've prepared a special Guide To Benchmarking that is included with the full report. The guide provides a framework for integrating financial benchmarking into a management planning strategy and suggests some specific actions which when implemented, can improve your profit and cash flow.

If you participated in the study, thank you for making the process possible.

Sincerely,



Steven C. LeFever
Business Resource Services
Chairman



Barbara Carper, CPA
Business Resource Services
Project Director



Report Highlights

All International Franchise Association members having completed at least one entire year of franchising operations were invited to participate in the study. Financial information was received from 65 companies for the 2001 study and 58 companies for the 2002 study. The results of both study-years are presented in the 2002 Financial Benchmarking Study. Since not all companies participated in both years, some differences in the results between 2001 and 2002 are due to the change in the survey population. This makes it impossible to say with certainty that the trends described in the study accurately reflect the trends of the franchising industry. Still 57% of the participants for 2002 had also participated in the 2001 study, making a substantially consistent base. Further, we compared the profitability of the 2002 first-time participants to the companies participating in 2001 but not 2002. Their results were similar. Any differences were not sufficient to create misleading trends with respect to the profitability of the study participants.

Since the franchisors volunteered to participate in each year of the study and were not selected through statistical sampling methods, we cannot calculate the statistical likelihood that the participants are a representative cross-section of all franchisors. Therefore, our goal is *not* to state that the results published in the study reasonably reflect the results of the membership. Instead, *the purpose of the study is to determine which of the 65 participating companies had the most profitable franchising operations and to identify the drivers of their profitability.*

Here are some key issues revealed by the study:

- Half of the companies that participated in 2002 had more than 11.9% in profit from franchising (as a percentage of total franchise revenue), up from 9.8% in 2001.
- The average profit from franchising for the top performers was 45.6%, up from 40.0% in 2001.
- Business services and personal services generated the highest profits from franchising, for both 2001 and 2002.
- Food, retail and maintenance franchisors participating in 2002 appeared to show losses from franchising, though their company-owned locations more than offset the losses.
- Executive salary costs were highest for participants with franchise revenues under \$2 million, (at 41.1% of franchise revenue) and for retailing franchisors (at 45.1% of franchise revenue)
- Approximately one-fourth of the companies in the top 25% had less than \$5 million in franchise revenue for 2002 (one-third had less than \$5 million for 2001)
- The average participating franchisor grew by 16.7% during 2002 (based on new franchise units added) as compared to 9.4% in 2001.
- Franchisors of food franchises had the highest growth during 2002 at 17.7%

The purpose of this study is to identify the drivers of profitable franchising, so we isolated the results of franchising from the results of operating company-owned locations. **All revenues and expenses related to company-owned locations were combined and are shown as a single item on the income statement just below profit from franchising (see *Profit From Company-Owned Locations* in the table on page 6).** The 100% number on the income statement becomes total franchise revenue, *excluding operating revenue from the company-owned locations*. This is different from conventional income statements where all revenues, including those from company-owned locations would be used to arrive at the 100% number.

This means that our analysis is based on an approach that is probably very different from the ways you've evaluated your operations in the past. Your financial management team's involvement will be critical to interpreting how your company compares to the results of the study participants.

Top 25% of Performers Based on Profit From Franchising

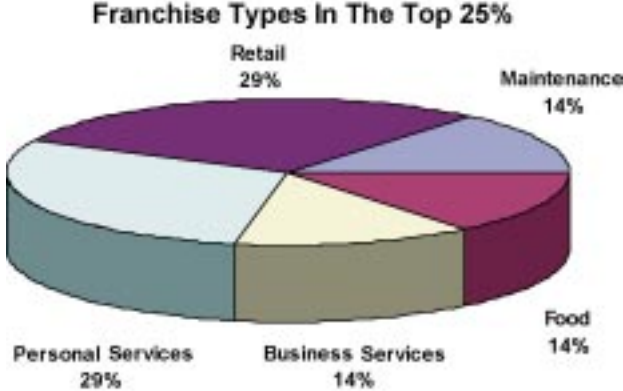
	2001	2002
Franchise Revenues	100.0%	100.0%
Cost of Goods Sold	5.7	7.8
Gross Profit	94.3	92.2
Employee Expenses	27.5	20.1
General, Administrative and Operating Expenses	26.9	26.6
Profit From Franchising	40.0	45.6
<i>Profit From Company-Owned Locations</i>	3.5	(8.4)
Other Income / (Expense)	(3.3)	(1.2)
Profit Before Tax	40.2%	35.8%

Lower employee expenses for the top performers contributed to increased profit from franchising (45.6%, as compared to 40.0% in 2001).

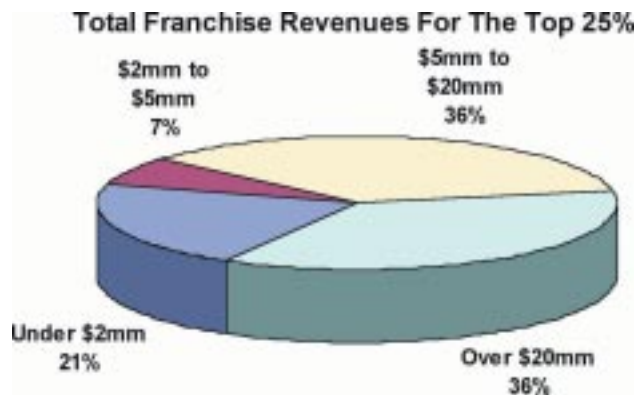
Who Made It To The Top 25%?

Study participants proved there's more than one way to make it to the top. The top 25% were defined as those with the highest profit from franchising as a percentage of total franchise revenues (more than 18.2%).

Here is some information about the companies who made it to the top 25%.



Retail and personal services made up the largest shares of the top 25% for 2002.



Almost three-fourths of the companies in the top 25% had franchise revenues greater than \$5 million. However, smaller companies who managed expenses efficiently were still able to achieve top 25% status.

Profitability

There were some important differences between the participating companies, depending on whether they focused on company-owned locations as a primary profit center or whether they instead focused on franchising (with negligible operations of company-owned stores). Participants focused on franchising rather than operating locations were statistically more efficient at generating profits from franchising. In fact, many participants that focused on company-owned locations as a profit center actually appeared to show losses from their franchising operations. This could be due in part to not allocating location-related expenses to the locations, and instead considering them operating costs of the franchisor. Since these two groups of companies were so different, combining them into a single category would meld the dissimilar data into a single average that would not be meaningful to either group. To establish benchmarks that would be more meaningful, each company was assigned to one of two categories based on their degree of company-owned locations:

5% or More Company-Owned: Those participants having corporate ownership of more than 5% of their total locations. *For example, a participating member-company with 100 stores would be included in this category if 5 or more locations were company-owned.*

95% or More Franchise Focused: Those participants with 95% or more of their total locations owned by franchisees. *For example, a participating member-company with 100 stores would be included in this category if 95 or more locations were owned by franchisees.*

For 2002, top performers have 45.6% in profit from franchising, compared to 5.3% for the participating companies that focused 95% or more on franchised locations. Companies owning 5% or more of their total locations appear to show an *average loss from franchising of 18.4% of franchising revenues*. Higher employee expenses, general administrative and operating expenses all contributed to the losses. Profit from company-owned locations offset franchising expenses.

**Profitability
Breakdown Chart**

	2001			2002		
	<i>All 65 Companies</i>			<i>All 58 Companies</i>		
	<i>5% Or More Company- Owned</i>	<i>95% Or More Franchise Focused</i>	<i>Top 25%</i>	<i>5% Or More Company- Owned</i>	<i>95% Or More Franchise Focused</i>	<i>Top 25%</i>
Franchise Revenues	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of Goods Sold	14.5	10.0	5.7	10.7	11.8	7.8
Gross Profit	85.5	90.0	94.3	89.3	88.2	92.2
Employee Expenses	56.2	34.9	27.5	50.4	40.5	20.1
General, Administrative and Operating Expenses	68.5	39.6	26.9	57.4	42.4	26.6
<i>Profit From Franchising</i>	<i>(39.1)</i>	<i>15.5</i>	<i>40.0</i>	<i>(18.4)</i>	<i>5.3</i>	<i>45.6</i>
<i>Profit From Company-Owned Locations</i>	<i>91.0</i>	<i>.6</i>	<i>3.5</i>	<i>35.4</i>	<i>6.7</i>	<i>(8.4)</i>
Other Income/(Expense)	(14.1)	(2.9)	(3.3)	(5.5)	(1.3)	(1.2)
Profit Before Tax	37.9%	13.2%	40.2%	11.5%	10.7%	35.8%

For 2001, franchisors with 5% or more company-owned locations earned almost as much in profit from those locations as they received in total franchise revenue (profit from company-owned locations was 91% of total franchise revenues). Note that this is 91% of franchise revenues – not a 91% profit on sales at their company-owned locations. The actual profit margins earned from sales at company-owned locations varied widely among the participants. Some were service businesses with very high profit margins and some were retail or other types of companies with moderate or low margins. Since the goal of this study is to evaluate franchising, we did not assess the efficiencies of the company-owned locations themselves.

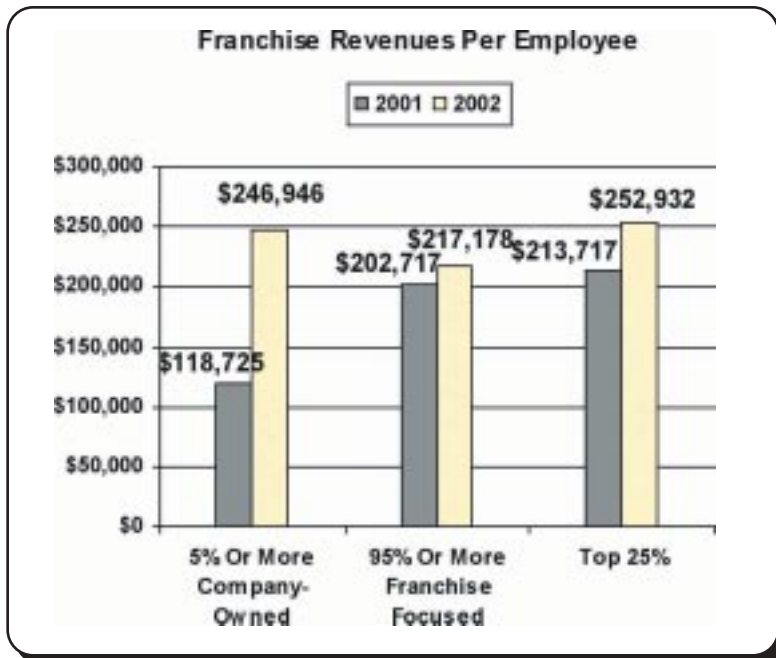
The information presented here makes it appear that franchisors with a significant number of company-owned locations are less likely to realize high profits from the franchising of their business. By the numbers, these companies appeared to show an average loss on the franchising portion of their business. This loss was offset by profit from their company-owned locations.

Franchisors with a significant number of company-owned locations share resources with their franchisees and may rely on the profit from the locations to pay executive salaries and other overhead items. Because franchisors use different methods to allocate portions of their corporate operations to the franchising part of their business, it can be difficult to make comparisons or draw conclusions about their corporate operations. To get an accurate assessment of how corporate and franchisee-operated units contribute to overall profitability of the franchisor, franchisors should make sure their expenses are reasonably allocated.

Productivity

Optimum productivity is the result of efficiently controlling staff costs while maximizing revenues (that is, the effectiveness of efforts). Franchise revenue per employee is a benchmark for measuring the effectiveness of efforts.

This chart shows that the employees of the top 25% were more productive as measured by franchise revenue per employee. All categories of participants showed improved productivity when considering the 58 companies participating in 2002 as compared to the 65 participants for 2001.



Want More Details?

The **2002 Financial Benchmarking Study** includes answers to more detailed questions about profitability and productivity, like:

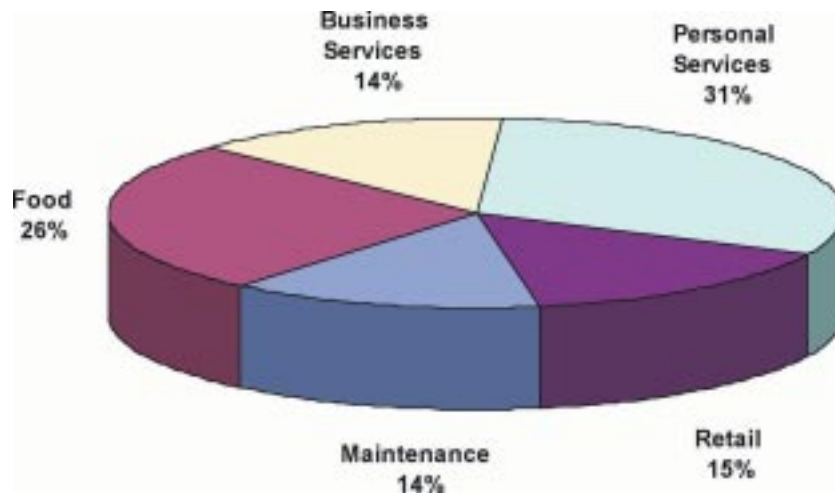
- ✓ How much of franchise revenues were from royalties, versus initial franchise fees, product or service sales to franchisees or other revenues?
- ✓ How much of the employee expenses were for franchise services, franchise development or executives and administration?
- ✓ How much of the operating expenses were for occupancy, franchise development, franchise services or compliance?
- ✓ What is the average number of employees per franchise unit?

You'll also find detailed analysis of profitability, productivity, financial position (asset efficiency and debt management) and cash flow.

Type of Product or Service Franchised

The 58 companies participating in 2002 had franchise activities in the following categories:

Participating Companies By Franchise Type



Participants in the food and retail categories had substantial company-owned locations, creating additional indirect employee and administration costs. This resulted in losses from franchising that were offset by profit from company-owned locations.

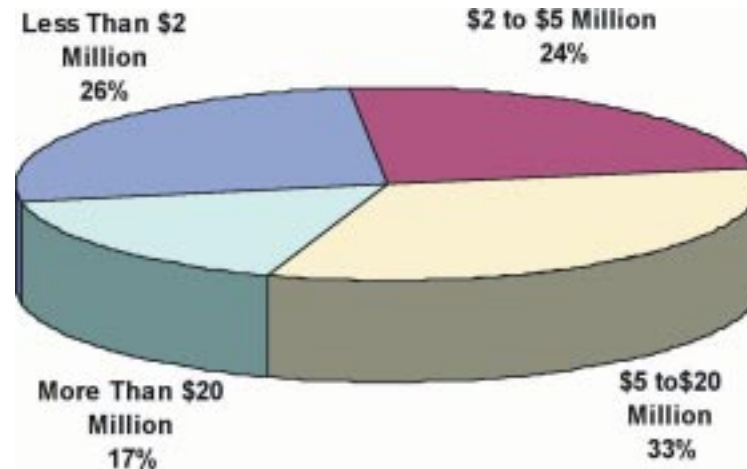
	Mainten- -ance	Food	Business Services	Personal Services	Retail
Franchise Revenues	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of Goods Sold	4.4	12.2	15.4	12.4	11.1
Gross Profit	95.6	87.8	84.6	87.6	88.9
Employee Expenses	37.6	53.1	29.3	36.4	59.9
General, Administrative & Operating Expenses	80.8	43.0	33.7	36.3	57.0
Profit (Loss) From Franchising	(22.9)	(8.3)	21.5	14.8	(28.0)
Profit From Company-Owned Locations	35.6	30.4	(2.7)	(5.0)	30.4
Other Income / (Expense)	1.1	(12.8)	(3.0)	5.3	(4.1)
Profit Before Tax	13.8%	9.3%	15.9%	15.1%	(1.7)%

Based on the 58 companies participating in the study during 2002, the highest profit from franchising was earned by franchisors of business services. This category included mailing services, phone services, tax preparation, printing, corporate training, and temporary placement services.

Franchise Revenue Categories

The 58 companies participating in 2002 had total franchise revenue in the following categories:

Study Participants By Total Franchise Revenue



The median franchise revenue for all 58 participating companies was \$5.24 million. The median initial franchise fee was \$25,000 and the median royalty was 5%.

Employee efficiency and overall profitability were highest for companies with franchise revenues over \$20 million, as would be expected. Executive and administrative salaries were the highest for companies with franchise revenues under \$2 million, at 41.1% of franchise revenue. Their median staff cost per employee of \$55,833 was the lowest of any revenue category, indicating their low revenues require that a higher percentage of their total resources be devoted to executive and administrative compensation.

Companies with franchise revenue under \$2 million spent 10.1% of franchise revenue on franchise development. As companies grew, that percentage decreased (to only 1.9% for companies with franchise revenue of \$20 million or more).

General Information About the Participating Companies

Locations

2001

The median percent of new franchises opened for the 65 companies participating in 2001 was 9.4%. We calculated the percentage of new franchises by comparing new franchises opened during the year to franchised locations at the beginning of the year.

	Franchised Locations	Company-owned Locations	Total Locations
Beginning of the year	414	55	469
Add: New Franchises Awarded	35	2	37
Add: Franchisees Acquired	2	0	2
Deduct: Terminations And Closures	(24)	(9)	(33)
End of the year - Average Per Participant	427	48	475
Total Locations Of All Participants	27,810	3,135	30,945

2002

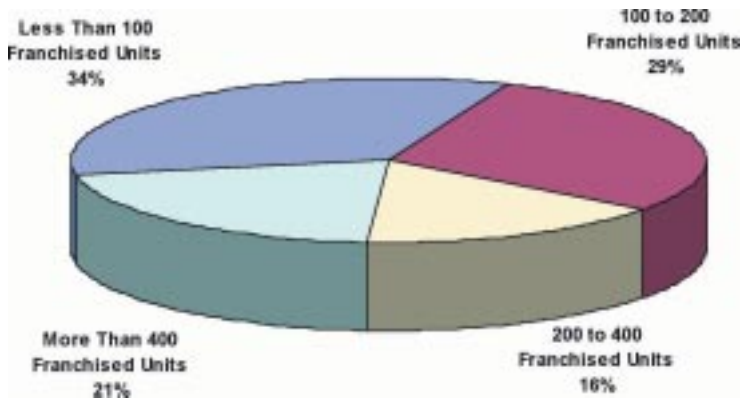
Of the 58 companies participating in the study, 18 operated at least 5% of their locations themselves while 42 franchised at least 95% of their locations. Here is a summary of the average number of locations for the 58 participating companies.

	Franchised Locations	Company-owned Locations	Total Locations
Beginning of the year	362	10	372
Add: New Franchises Awarded	37	1	38
Add: Franchisees Acquired	4	1	5
Deduct: Terminations And Closures	(22)	(1)	(23)
End of the year - Average Per Participant	381	11	392
Total Locations Of All Participants	21,100	665	21,665

The median percent of new franchises opened for the 58 companies participating in 2002 was 8.1%.

Here is a breakdown of the number of franchise units reported at the end of 2002 by the companies participating in the study:

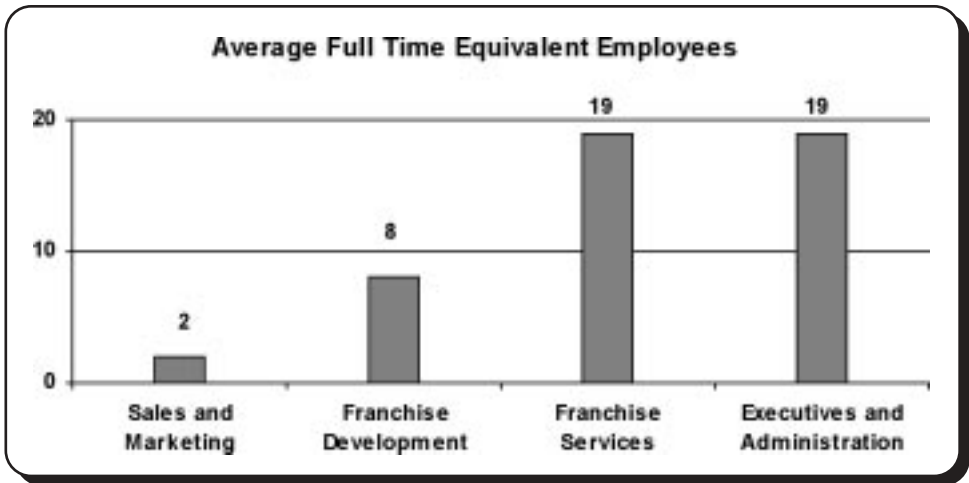
Study Participants By Number of Franchise Units



Four companies each had more than 1,000 franchised units. This caused the average number of franchised units for the 58 participating companies to be 381, even though 84% of the 2002 participants had fewer than 400 franchised units. The median number of franchised units was 128 (half of the 58 participants had more than 128 franchise units and half had less). For the 65 companies participating in 2001 the median number of franchised units was 159.

Employment

Respondents were asked to report their full-time equivalent employee units (FTEs) in various categories of their franchising operations. The average responses are shown above.



National Ad Fund Contributions

Forty-two of the 58 companies participating for 2002 reported that they collected for a national advertising fund (49 of 65 participants for 2001). The average levy was 2.4% for both 2002 and 2001. For 2002, only five of the 58 participants had a limit on the amount of franchisee revenues subject to the advertising levy. The average annual revenue limit for those applying such a ceiling was \$396,600. For 2001, only three of the 65 participating companies had a limit on the amount of franchisee revenues subject to the advertising levy. The average annual revenue limit for 2001 participants was \$568,800.

Age and Years Franchising

The average age of the 58 companies participating in 2002 was 21 years, with an average of 15 years in franchising. For 2001 the average age of the 65 participating companies was 25 years with 16 years in franchising. Here is a breakdown of the participating companies:

	Age of Company		Years In Franchising	
	2001	2002	2001	2002
Less than 10 years	15%	19%	34%	40%
10 to 19 years	29%	29%	36%	33%
20 to 29 years	30%	31%	15%	12%
More than 30 years	26%	21%	15%	15%
Total	100%	100%	100%	100%

Conclusion

These report highlights are just a sampling of the findings of the 2002 Financial Benchmarking Study. The full report includes group composites of financial ratios, balance sheet and profit and loss profiles for these groups:

Top 25%

Based on profit from franchising

Franchise Focus

5% or more company-owned units compared to 95% or more franchised units

Franchise Type

Maintenance, food, business services, personal services and retailing

Franchise Revenue

Less than \$2 million, \$2 to \$5 million, \$5 to \$20 million and more than \$20 million

The full report also includes the Guide to Benchmarking that provides a framework for integrating financial benchmarking into your own business management strategy. If you're looking for specific suggestions for improving your profit and cash flow, you'll find them in the full report.

If you participated in the 2002 Financial Benchmarking Study you'll automatically receive a copy of the full report along with your confidential report detailing how your company compares to similar companies that participated in the study.

If you didn't participate in the study but would like to receive the full report, you may purchase a copy from the Education Foundation of the International Franchise Association.

Sign Me Up!

Yes, I'd like my company to participate in the *2003 Financial Benchmarking Study*. For participating in the study I'll receive a copy of the full report for 2002 as well as the 2003 report and my 2003 confidential management report. Please send the survey form to my attention.

Name _____

Title _____

Company _____

Address _____

City, State and Zip Code _____

Phone number _____

Fax number _____

Email address _____

Please mail to –

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IFA Education Foundation
1350 New York Avenue NW, Suite 900
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Or fax to – 202-628-0812