



Franchise Financing Strategy

Our Challenge

Social Capital Partners has spent the past four years supporting social enterprises across the country and learning how to start and run businesses that balance dual missions. During that time we have worked with several talented social entrepreneurs and remarkable enterprises, most of which we continue to support.

At the same time however, we have come to understand just how challenging it is to start a social enterprise, or any business for that matter, from scratch. If one considers that a typical private sector entrepreneur must manage dozens of business-related variables in order to reach financial success it is only logical that a social entrepreneur must control dozens more variables in order to reach *both* financial *and* social success. This challenge is compounded by the fact that truly great social enterprise business models are difficult to find.

In early 2005, as a result of this learning, we began researching ways in which we might increase the probability of success for social enterprises by controlling some of the variables inherent in any business. In essence, we were looking for ways to invest in proven business concepts with well-defined operating models that would make the business easier to run while at the same time allowing the social mission to be successfully introduced.

Why Franchises?

The realization that franchises may be just the right business model to accomplish our goals was inspired by conversations with one of our community partners - the YMCA of Greater Toronto. The YMCA introduced us to two entrepreneurs who had each faced employment barriers in their lives. One had immigrated to Canada and had trouble integrating into the workforce despite his significant overseas experience and the other was a young person who had limited education and a somewhat troubled youth but an excellent ability to work with his hands.

Both of these individuals overcame their challenges with help from YMCA employment programs. Over time and through hard work they each built enough capital to purchase their own franchises.

Today, both individuals operate successful franchises and have chosen to hire the majority of their employees from the YMCA job training programs that once helped them to overcome their employment barriers. In essence these entrepreneurs have gone full circle to help those who are facing employment barriers similar to what they once faced.

We were intrigued by these examples and began testing the idea that franchises might be the ideal business model for SCP. We worked with our strategic partner The Monitor

Group to understand the franchising landscape in Canada and engaged an expert franchise-consulting agency called Northern Lights to convene a series of focus groups with respected franchisors in order to get their opinions on the concept of “social enterprise franchises”.

Through this research we came to view franchises as strong potential vehicles for accomplishing our mission. We also learned that there were several highly respected franchisors interested in working with SCP on this program.

From a financial standpoint, we believe that investing in franchises will allow us to overcome some of the inevitable risks involved in starting a new business. We have significant experience starting small ventures and have seen first hand the challenges associated with such endeavours. As such, we are acutely aware of the value an established brand name, proven operating system, on-going support and, in certain cases, national purchasing power can provide.

From a social standpoint we see significant benefits as well. Working with an established business formula will allow our businesses to grow profitably while continuing to hire employees from a target community. Moreover, we believe that the ongoing support and training provided by franchisors fits nicely with our desire to provide skill development opportunities for the employees of our portfolio companies.

It is important to note that this franchise financing strategy does not replace our work with more “traditional” social enterprises. It simply provides us with another avenue that we hope will help make the concept of social enterprise more mainstream in Canada.

How Will Our Franchise Financing Program Work?

Our intention is to provide subordinated debt to finance most of the “unencumbered” capital required to purchase a franchise. This type of financing is generally difficult for franchisees to secure because banks will not provide loans for this purpose.

The amount of financing available from SCP will be a maximum of \$300k per franchise but the actual amount will vary depending on the needs of a particular franchisee. The critical component, of course, is that any franchisee receiving financing from SCP will be required to hire at least 50% of his/her employees through community programs that help those facing employment barriers.

Our financing will be structured as subordinated debt so that it can be viewed as equity by more senior lenders. Our interest rates will be calibrated relative to traditional small business loans and the term of the debt will be tailored to the projected cash flows of the business (likely 5 to 7 years). There will also be an assortment of other covenants (e.g. personal guarantees, adequate financial reporting etc.).

Who Are The Target Franchisees?

We envision two types of entrepreneurs who would qualify as potential franchisees.

The first group would be candidates who have the necessary management and people skills to operate a franchise but who need help financing the acquisition. These individuals must also possess a strong willingness to embrace the social mission.

The second group would be recent immigrants to Canada who have displayed entrepreneurial and management capabilities in their homeland before arriving in Canada. This is a way to bring an added social dimension to our franchise program because many new immigrants have the requisite skills and work ethic to become successful franchisees but lack the credit history, networks, or access to capital that would allow them to qualify. Our financing program would eliminate those structural barriers and allow them to make a much more productive contribution to their new chosen country. At the same time they would be giving back themselves by hiring the majority of their staff through our community partners.

How Will the Franchisor Benefit?

We believe that there is a clear opportunity for SCP and our target populations to benefit from this franchise financing strategy – but it is not a one-way street. A franchisor will also benefit from a relationship with SCP in a number of ways.

First, access to SCP financing will help franchisors expand their network while ensuring that a franchise is fully supported and appropriately capitalized.

Second, our financing program will provide a vehicle for franchisors to grant franchises to individuals who have all the necessary business and personal qualities but lack the unencumbered capital. For instance, franchisors could potentially award a franchise to a successful manager of a company-owned store who would not otherwise have the financial net worth to become an “owner”.

Third, we believe that the franchisor will benefit from the positive public sentiment that comes from doing business while “doing good” in the community. Social Capital Partners and its portfolio organizations have been featured favourably on CBC’s Venture, in the National Post, the Globe and Mail, The Toronto Star, and several other local and national publications.

Fourth, our partnership with the YMCA and other dynamic community organizations in addition to our own experience in establishing appropriate social support infrastructure in the social enterprises we fund allows us to ensure that people hired in the franchises

are properly screened, trained and supported. This will permit the franchise owner to concentrate on the business aspects of building a successful operation.

Finally, as with all of our portfolio companies, we will provide ongoing strategic and management support to help to ensure that the franchise is a success.

Potential Pitfalls

As is the case with all creative ideas there are some potential pitfalls that SCP will have to avoid. We see three particularly important challenges in this case.

The first is that franchises often operate in sectors that do not provide ideal job opportunities or remuneration for employees. Thus SCP will choose to avoid franchises that provide less robust job opportunities and/or ensure that the target population being employed is appropriate for that job. For example, a job in a fast food restaurant may be completely inappropriate for skilled immigrants looking to integrate into the Canadian job market but may be a good opportunity for at-risk youth looking to develop basic employability skills.

A second concern is that a franchisee that is financed by SCP may face mixed incentives. On one hand the franchisor will demand business performance in line with other franchise units while on the other hand SCP will put pressure on the franchisee to execute effectively on the social mission. To mitigate this potential conflict we will provide assistance to franchisees around hiring and training their target employees. Much of this assistance will be provided in cooperation with community partners such as the YMCA. We will also help to create a positive and competitive work environment by providing technical and monetary support for programs such as emergency loan funds, employee savings programs, education bursaries, and financial literacy courses.

An additional concern is that some communities (particularly smaller ones) may be wary of the effect that franchises have on local owner-operated businesses. It is important to note that in most cases our franchise operations will be in larger urban centres where these concerns are not as acute. In all cases, we will work hard to minimize any potential conflicts with local community members.

The Way Forward

To begin testing this strategy we have decided to pilot our new financing program with two franchises over the next year in order to understand the process that is involved and develop methods for overcoming any challenges. To that end, we have made two franchise investments in the Greater Toronto Area.

Our first investment is in an Active Green and Ross (AGR) franchise. Active Green and Ross provides tire and automobile care through its 50 locations in Ontario. We believe that AGR is an excellent franchise partner because it provides good paying jobs, strong

training opportunities, and marketable job skills. We have also been impressed with the strong overall interest expressed by senior management at Active Green and Ross in the social mission of SCP.

Our second investment is with a company called Two Men and a Truck (TMAT). TMAT is a moving company with a large presence in the United States market. The company has just recently expanded to Canada and is actively granting franchises across Ontario. We feel that TMAT will be an excellent partner for SCP because it offers entry-level positions that are relatively well paid where employees have opportunities for skill development and advancement in areas such as truck driving and customer relations. Senior management at Two Men and a Truck have shown a very strong interest in the social mission and a great desire to give back to the community.

Our plan is to develop our relationships with these franchisors and to learn from our initial investments. Once we feel comfortable that the franchise model works from both a social and business standpoint we will work with AGR, TMAT, and other franchisors to roll out the strategy nationally. Over the long-term we believe there could be hundreds of franchises utilizing social enterprise principles to employ thousands of individuals across the country.