How To Raise the Money For Your Fitness Business

"At AFS one of our biggest priorities is connecting our members so they can leverage the combined experiences of each other to maximize their growth potential."

– Josh Leve, Founder & CEO, Association of Fitness Studios

ASSOCIATION OF FITNESS STUDIOS

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Of all the challenges that an entrepreneur faces in attempting to bring their dream to life, raising the capital necessary to make it happen can be the most daunting and frustrating. Many entrepreneurs, especially trainers and instructors seeking to open and operate their first studio, fail to realize the challenges inherent in raising the funds to bring their vision to life. In this chapter we will provide insights that will serve as a guide in helping capitalize your vision.

How Much Capital Will Your Vision Need?

Before beginning the process of acquiring funding for your vision, you need to prepare a budget that details the financial requirements for fulfilling your vision. The budget must address the capital required to start the business as well as the capital needed to support operations while you are building a revenue stream.

- *Create a start-up budget that addresses every dollar you are likely to need to get the doors open.* The start-up budget should address the hard and soft costs associated with opening your studio.
  - *Hard costs.* The hard costs for opening a studio include the costs to retain an architect (most commercial space requires an architect to be involved), construction costs (also referenced as tenant finish-out costs) and equipment costs (fitness equipment, sound systems, computers, furniture, etc.). Hard costs can vary significantly depending upon the size of the studio, the level of finish desired, the amount of equipment needed, and finally, potential landlord contributions to the finish-out of the leased space. Costs can run as little as $15 per square foot to as high as $100 per square foot before accounting for equipment.
  - *Soft costs.* The soft costs relate to the operating and development costs necessary to open the studio. These costs can include, but are not limited to, items such as: the cost to develop your brand materials, the cost to develop your web site, fees associated with marketing your studio during pre-opening, costs for pre-opening staff or contractors, costs for basic operating materials, the cost to activate your utility, phone and internet service, and so forth.

- *Create a five year annual operating budget and a month-by-month operating budget for the first year.* Your operational budget reflects the revenues you expect to generate and the expenses you will incur. While it is difficult to estimate your monthly revenues and expenses over five years, it is a requirement to do so for the first year. Why so much detail for the first year? Well, most entrepreneurs believe that they will immediately start generating the revenues necessary to cover their expenses, but reality says it will take months to get to the point where you are generating sufficient revenues to cover your operating expenses, let alone generate a profit. During the time your expenses exceed your revenues you will want to have the working capital to keep your studio afloat. This is where most studio owners and entrepreneurs miscalculate their financial needs.

  When your expenses exceed revenues, and thus your business requires financial support, investors refer to this as the “burn rate.” Most investors want to know what the monthly burn rate is, meaning how much will it cost them to support the business until the revenue stream is sufficient to cover costs, and eventually generate a profit. Therefore it is incumbent upon the entrepreneur to estimate what the monthly burn rate will be and for how long it will take place, since this will allow you to estimate the additional operating capital you will require for the business. Sound business practice is to budget for at least six months operating capital (six months monthly burn rate) that will ensure you have sufficient capital to get through the first six months of operation. Ideally, you should budget for one full year’s operating capital, even if you don’t have to use it. It is always better to prepare for the worst case scenario and over achieve then to budget for the best case and under achieve.

Finding the Money

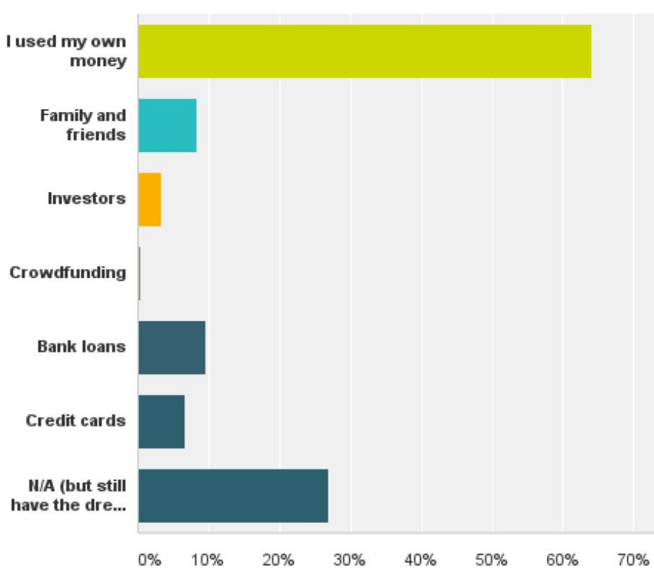
Once you have a reliable estimate of your financial requirements it is time to raise the money. Raising money will probably be the most challenging venture an entrepreneur takes, as the journey is filled with numerous hurdles and frequent bouts of frustration. So, where do you find the money to capitalize your vision?

- *Personal equity.* Personal equity is the cash you personally contribute to the venture. In most instances, entrepreneurs have minimal equity to put into a deal. Typically, entrepreneurs - in this case future studio owners - may have a small stash of cash that they have saved over the years that can be applied to the venture. It is important for entrepreneurs to contribute equity to their venture, even if it's not very much. Investors always want to know you have "skin in the game," meaning you have capital at risk if the venture does not succeed. If you are pursuing a small business loan, the lender will require an equity contribution.

- *Friends and family.* The term friends and family refers to family members, friends, business associates, existing clients and acquaintances. Friends and family are those most likely to place trust in your vision and have an intimate knowledge of your expertise. Depending on the amount of capital being sought (usually smaller capital requirements), friends and family can often provide the balance of funding an entrepreneur requires. Raising capital from family and friends brings with it certain risks, particularly if the venture does not succeed. When raising capital from your family and friends it is best to have an attorney first draw up a term sheet and later an operating agreement that spells out what the investor will get in return for their contribution of capital.

In a recent AFS Fitness Studio Industry Research Study, we found that nearly 65% of studio owners used their own money when starting their business.

How did you raise the money to start your business?



Answer Choices	Responses
I used my own money	64.16%
Family and friends	8.36%
Investors	3.24%
Crowdfunding	0.51%
Bank loans	9.56%
Credit cards	6.66%
N/A (but still have the dream of opening my own studio)	26.96%

The responses to this question also indicate that 27% of fitness professionals are, at any one time, looking to open their own studio.

However, what's important to point out is studios can take advantage of being "asset light." The principle and practice of not tying up significant amounts of capital (cash) in depreciable assets, such as facility improvements and equipment or fixed operating liabilities such as rent.

- This is because of two specific reasons…
  (1) Smaller physical footprint. In our latest research we found the average studio is 3,700 square feet. Anywhere from 5x to 10x smaller than the traditional fitness facility. This results in lower build out costs (design and construction) and lower overall rent costs.

  (2) Less equipment intensive. The vast majority of studios don't require significant investment. However, it's safe to say many, if not most of the studio disciplines spend less, sometimes much less than $100,000.

  When you compare this to the $250,000 to $1,000,000 that some big box clubs spend, it's next to nothing. The result is less fixed costs, less debt and a financial operating advantage.

If you are serious about seeking funding from an angel or angel network there is a web site called Gust www.gust.com that helps connect entrepreneurs and angel investors.

- *Venture Capital.* Venture capital represents money provided by institutional investors who seek to invest in start-ups with long term growth potential and have the ability to generate high returns. Venture capital firms refer to this as 'seed capital.' Venture capital firms are not individuals or a network of angel investors; instead they are professionally managed firms that oversee investments for large investors (individuals, pension funds, businesses, etc.). Venture capital firms are investing other people's money, not their own, so their expectations are quite different than those of angel investors.

- *Crowdfunding.* Crowdfunding is a new twist to an old approach to fund raising that has emerged over the past decade. Crowdfunding leverages the interests and passions of friends, associates and consumers to raise monetary contributions to fund a business venture. In 2013 crowd funding reportedly generated over $5 billion. The crowdfunding model involves three key elements. First, is the entrepreneur who has identified a business solution they want to bring to market. Second, is the cloud-based platform that exposes the entrepreneur's business proposition to a global audience of potential contributors. Third are the potential contributors, individuals who have an interest or passion for the business proposition.

Some interesting facts about crowdfunding:

(1) Create a dynamic crowdfunding site with video, images and testimonies. Even better, have someone well-known behind your project.

(2) Your success rate will go up the more Facebook friends and LinkedIn contacts you have. According to some sources entrepreneurs with at least 1,000 friends have a 40% chance of success.

(3) Crowdfunding is no slam dunk. In 2012 the average success rate for crowdfunding was 50%. Kickstarter indicates its success rate is 44% and Indiegogo reportedly has a success rate or 34%.

(4) The average campaign on Kickstarter raises about $7,000, while the average failed campaign raises $900. The typical pledge is $75.

(5) Understand that most crowdfunding sites take 3% to 9% of the revenues right off the top. Other costs associated with attracting contributors can consume as much 30% of what you raise.

- *Bank Debt.* Bank debt, otherwise known as a bank loan is probably the most prevalent form of funding for entrepreneurs other than personal equity and possibly investments from friends and family. The most popular form of lending pursued by entrepreneurs, and definitely the approach of choice for studio operators, is a small business loan from a local bank that is guaranteed by the U.S. Small Business Administration (SBA).

The terms of an SBA loan are typically negotiated between the entrepreneur and the lender, and therefore the specific terms of a loan will depend on negotiations between the lender and the borrower.

For more information about SBA guaranteed loans go to *www.sba.gov.* that helps connect entrepreneurs and angel investors.

What Does the Money Go Toward?

In another AFS research report, we found, by a huge margin, the single largest expense for fitness studios was staff costs with an average of $144,477. Rent was the second largest expenditure with an average of $51,141 (figure 41). When expenses were broken down across the various studio segments, as one would expect, those facilities over 5,000 square feet generated the highest average expenses.

In every instance, staffing costs were the single largest expenses across the various size studios with the highest being $382,500 in studios over 5,000 square feet. Rent was the second largest expense across the various size segments, with rent costs increasing, again, as one would expect, as the footprint of the facility increased (studios over 5,000 square feet reported an average rent of $134,401).

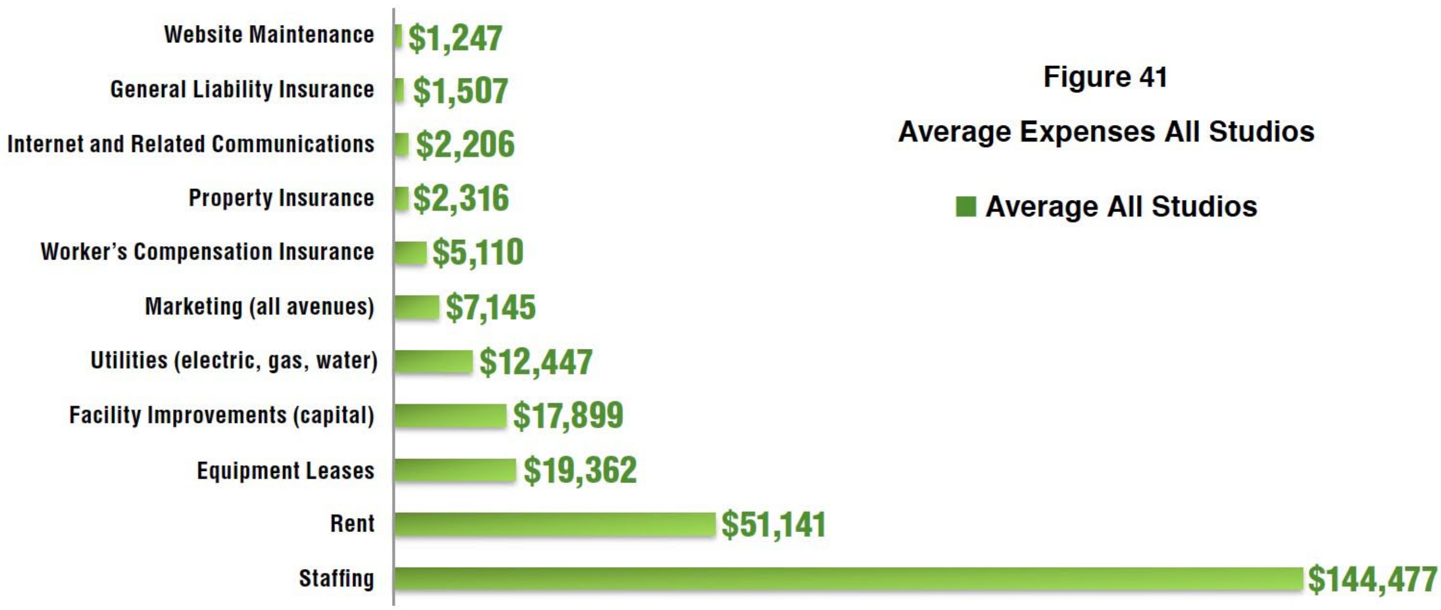


Figure 41

Average Expenses All Studios

Without sufficient funding your studio will be doomed to fail. Not only is it important to get funding, but it is essential to raise sufficient capital to sustain your studio through its first year of operations. You don't want to go back to the well more than once if you can help it, therefore it's essential you understand the financial demands that your studio will require.

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