FRANCHISING WORLD®

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CHOOSING THE RIGHT MULTI-UNIT APPROACH

SHANNON HUDSON
CEO, 9ROUND

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FOOD & BEVERAGE 2019 FRANCHISE DIRECTORY

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MULTI-UNIT BRINGS THE X-FACTOR

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MULTI-UNIT TO MULTI-BRAND

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★ Features

PRIVATE EQUITY IS MORE ART THAN SCIENCE

Tips for determining your need, navigating the process and finding the right investor.

By Steve Beagelman, CFE

> "Private equity firms do not take a one-size-fits-all approach to investing in a brand."

In franchising, the ultimate goal for many brands is an investment from, or acquisition by, a private equity firm. As you are growing your franchise brand, the thought of private equity has likely crossed your mind at some point. Securing private equity takes many shapes and forms, and is often a complex process. Your approach to pursuing an investment should be strategic, thoughtful, and most importantly, the right fit for your brand and for you as the franchisor.

TV shows like *Shark Tank* or *The Profit* offer a good illustration of the variety of forms a private equity deal can take, in terms of investment level and ownership stake. In some cases, contestants turn down offers after realizing that selling even

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a portion of their business is not right for them. This is exactly how it works – private equity firms do not take a one-size-fits-all approach to investing in a brand. Before pursuing an investment, franchisors need to understand how it works and what to be aware of during the process.

ANATOMY OF A P/E DEAL

The major benefit of a private equity investment is an influx of capital to grow your business that you wouldn't be able to get on your own. What should also be considered is the level of sophistication, like accountability, structure, controls and fiscal responsibility, that an investor will look for. Most investors will help you focus on improving the company's profitability – including creating budgets, reviewing proformas and costs of goods – and sharing their connections to new vendor partners, industry knowledge and other resources the franchisor might not already have.

Unfortunately, there isn't a proven formula to securing an investment. It's more of an art than a science, and many factors come into play. Brands typically start getting interest from investors when they reach 25 to 50 units. That doesn't mean that smaller brands can't get an investment; it just needs to be under the right circumstances.

In 2016, K-9 Resorts Daycare & Luxury Hotels received a multi-million dollar investment from Navigator Partners. At the time, the brand had four units, which is relatively early for PE, but the company's excellent unit-level economics, operational systems and the very hot pet industry made it stand out from the pack. The owners remain majority shareholders and control the day-to-day operations, and secured the resources they needed to scale. This is a win-win scenario for all, and the PE firm added great resources and skills to help the company scale.

The K-9 Resorts example is uncommon, but shows that with the right elements in place, emerging brands can play with the big dogs.

NAVIGATING THE PROCESS

The investment process is generally complicated and takes far more time than one would expect. Hiring a third-party advisor to help you properly manage the process is the best strategy for long-term success. An outside expert, who has experience in these transactions, will serve as an advisor and take an objective approach, which the founder and owner of the business cannot. They will handle the vetting process of potential investors and prioritize your best interests.

Once you've secured your advisor, another important early step in the process is determining the level of ownership you're seeking. Some firms only want to do transactions to acquire controlling interest in brands, while others will do minority acquisitions. This information could be a deal-breaker on either end and should be discussed up front.

In addition to the level of ownership stake, it's also critical to determine the level of post-sale investor involvement. You should create the criteria for the ideal investor and work with your partner to find the best possible fit. Some franchisors want to sell a minority stake to secure capital to grow but want to retain ownership of the day-to-day operations. Other founders want the expertise and leadership of the investor. This decision is yours, but your wishes should be made clear and upfront to potential investors.

OTHER FACTORS

If you are selling controlling interest, be aware that the equity firm can relieve you of your duties after an agreed-upon period of time. It's also important to realize that even if you only sell a minority interest, your equity partner will want to be involved and have some say. If you want to control everything in your business, private equity is probably not the right growth strategy.

Regardless of how much involvement you're seeking, figure out a good balance, and stick to it throughout the process. It can be tempting to steer off course if you receive a high offer for more ownership, but stay true to yourself. An experienced advisor will help you narrow down your target list of investors who are interested in a deal that fits your brand and avoid wasting time.

As a franchisor, it's natural to consider pursuing an investment from a private equity company at some point. It can be an incredibly lucrative way to scale your business, but should not be taken lightly.

To approach private equity properly, it is imperative to leverage the right resources to help you understand the process and the different ways an investment can be structured, to protect yourself and your business.

Steve Beagelman, CFE, is President and CEO of SMB Franchise Advisors. He is a frequent guest speaker at IFA conferences and is a regular contributor to franchise industry publications. Learn more about SMB at franchise.org/smb-franchise-advisors-supplier.