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Five Insider Tips To Determine The Value Of A Franchise System



Forbes Finance Council

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POST WRITTEN BY

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Patrick Galleher, Forbes Councils



Is your private equity firm zeroing in on purchasing a franchise company as a [high-upside investment](#)? If so, you're obviously looking for the answer to that all-important question: Is this franchise system worth as much as the franchisor thinks it is?

That's a tough one. But I have some suggestions on how to pinpoint an answer because I live and breathe this world. I'm the managing partner at Boxwood Partners, a merchant bank in Richmond, Virginia, that is helping to fuel [franchising's private equity power boost](#). Our specialty, in fact, is assisting founder-owned businesses to find strategic financial partners for their next stage of growth.

Therefore, if you're a savvy investor looking to buy a franchise, I'd recommend diving deep into the system and getting your hands a little dirty before buying in. Here are five tips I'd suggest:

Get to know the management team.

Unless you're going to run the business yourself, you're going to want to have the founder or at least some of the C-suite executives stick around to maintain some stability and consistency. Obviously, this means you need to get to know them *well*. Talk to them. Ask questions. Ask them to ask you questions. You need to make sure you're in sync, and you need to believe in these people. You're buying the brand and assets, but people are assets, too. That may not sound like a compliment, but it's meant to be. If you can't work well together, this isn't going to work.

Study how the current franchise owners interact with the franchisor.

How are decisions made? Sure, the major ones that affect the company systemwide are made by the franchisor, but do the franchise owners get to offer input? Are their opinions actually valued by the company you're about to invest in or take over, or does the franchisor just seem to make a show of listening and then never implements ideas from the franchisees? It's nice to know what you're getting into: Is this a well-oiled machine that you'll be maintaining or a dysfunctional mess you'll be cleaning up? Granted, if you don't like what you see, you can certainly make changes to make the franchisees feel valued. But that's a tough road, as it's always difficult to regain trust, even if you didn't cause the original rift. (Quick idea for all: We started a private Facebook group with our sweetFrog Frozen Yogurt owners, and it's worked exceptionally well as a forum through which to share best practices, tackle challenges, celebrate success, etc.).

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How is the cash flow?

You will clearly want to study the franchise's profit and loss statements. Every franchise will have its top and bottom performers, but hopefully, you'll be seeing a lot of growth and potential in the top, middle and even in the bottom performers. A strong item 19 made public in the Franchise Disclosure Document (FDD) is a huge bonus, too, as it will help attract more qualified franchisee candidates. And, if the franchisor has been able to fund the company primarily with royalty fees and not had to continually borrow and take on debt, that's a good sign. A franchisor with a lack of capital is going to have trouble down the road. And you don't want to buy trouble.

Any legal battles?

This is a critical question that is all too often brushed off. Speaking of the FDD, any/all lawsuits and legal battles are described in detail in that document. Potential

franchise owners worth their salt will dig deep into the FDD before making a decision, and legal trouble is the number one warning sign. Even if it has nothing to do with your ownership group, legal trouble will leave a stink on the franchise opportunity that's hard to shake.

Is the franchise still growing?

Are existing franchisees buying and opening new locations? That's an excellent sign that the franchise isn't just growing but thriving. If this franchise system has a lot of franchise owners who have recently purchased their location or are looking to purchase a second and third location, that's a good sign that they're making money, and they'd like to make more. If, of course, this franchise has a history of franchisees selling and getting out of the franchise, you may want to ask yourself why you want in.

In other words, there's more that should feel right about the franchise system than the price. Otherwise, you'll pay for it later.

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