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How To Build A Franchisor That Is Attractive To Private Equity

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There's more to franchising than the allure of being your own boss and owning your ow business. If you're thinking ahead, you may already be looking at different growth strategies. You might even be eyeing an aggressive expansion strategy for new location or acquisitions. To do this, you'll likely need additional capital to make it happen. Man franchises are seeking said capital from private equity (PE) firms, and private equity is happy to oblige.

We've recently seen PE firms make significant investments into franchise systems. Roark Capital Group made waves in the franchising world when it purchased Buffalo Wild Wings for $2.4 billion in 2017. Similar acquisitions were made of other restauran concepts including Ruby Tuesday and Krispy Kreme Doughnuts. We're also seeing the same thing happening in other markets, like the fitness industry.

What do all these different concepts have in common? There are certain factors that investors consider when deciding if a franchise concept makes sense for them. What ar these considerations, and what can franchisors do to make themselves more enticing t investors? Here are a few of the things PE firms consider when looking at a franchise, and how they can help you.

Be Prepared To Show A Strong Track Record

One of the first things any potential investor is going to look at is the history of your franchise. How long has your business been around? How old are your franchises? The franchisor who can demonstrate stores that have been around for several years is going to appear as a much more stable investment than the new concept experiencing rapid but unproven growth.

A long history of profitability and success helps prove that your business is more than a flash in the pan. One way to demonstrate this is through Item 21 of your Franchise Disclosure Document, or FDD. Item 21 is the part of the FDD that requires franchisors provide audited financial statements for their company. These reports include balance sheets and statements going back for several years (often three years) that break down shareholder equity, operations and your business's cash flow.

With a thorough and well-researched audit at the ready, a franchisor should be able to answer any potential questions from investors and assuage any fears.

Does The System Work, And Is The Culture Strong?

Another key factor in the success of any franchise system is its ability to be replicated. After all, if you couldn’t replicate your success, it wouldn’t be much of a franchise. A franchise concept should be simple enough that virtually anyone can duplicate it anywhere.

This consistency in your brand across locations is a big indicator of the efficacy of your business model. Is it easy for franchisees to understand and follow your brand guidelines? Moreover, are your franchisees happy working in the system? As much as investors want to see a model that works, they also want to see a business model that fosters a positive company culture.

Don’t Forget About The Numbers

At the end of the day, it’s all about money. If the numbers don’t work, then it doesn’t matter how long you’ve been in business or the strength of your concept. One of the biggest advantages of investing in a franchise is it often provides reliable revenue streams PE firms can count on. When run properly, everyone in the system should be turning a profit. That goes for the franchisor, the franchisee and the parent company.

And there’s more than sales to consider when running the numbers. Your stores shoul also boast an earnings before interest, taxes, depreciation and amortization (EBITDA) that can attract the attention of PE firms. Your EBITDA might be the best indicator of your company’s cash flow. This is especially true in the eyes of investors. A key metric PE firms want to see is how the EBITDA of an established franchise compares to the cc of opening a new store. The better the ratio, the better you look to potential investors.

Much of this information will be available through your FDD. In addition to Item 21, Item 19 is where your business makes its earnings claims, also known as financial performance representations (FPRs). Your FPR will often include the average gross sales of your stores as well as breakdowns based on the square footage of each location Furthermore, the FPR provides detailed cost breakdowns of other factors, such as labo and goods. Item 19 and Item 21 are among the first places PE firms look when considering an investment in your business. That is why it’s so important to build a comprehensive audit that presents your company in the best possible light.

Make Sure You're Lawyered Up

One important consideration many entrepreneurs fail to take into account is a contingency plan for litigation. Investors want to protect their investment, and that means safeguarding themselves against potential legal actions of franchisees.

I'm not saying you're ever going to need your lawyer, but the saying goes that an ounce of prevention is worth a pound of cure. Retaining a trusted and capable law firm, particularly a highly regarded franchise law practice, demonstrates that you are prepared to prevent any potential litigation, leaving PE firms free to invest with confidence.

Put Your Best Foot Forward

These are only a few examples of what private equity firms are looking for when considering franchise investment opportunities. Obviously, these factors can vary wildl given the industry or franchise. That said, by showing healthy financial numbers, a proven concept, a thorough FDD and happy franchisees, you can prepare yourself to make a great first impression when the next PE firm comes knocking at your door.

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