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For Your Consideration

Franchisors can ponder 8 concepts before expanding abroad

By Dennis L. Monroe

Franchise companies often make mistakes in their international development strategy, and a common misstep is premature financing. Too often international development strategies are opportunistic rather than financially strategic.

When I talk to franchisors about international development, I often hear statements such as, "We've been approached by someone in an overseas country," or "Let's expand to Canada" or "Let's go to Mexico. It's an easy step-out." In many cases, these statements are made by franchisors who have limited knowledge of the country they are targeting or international expansion in general.

Another common misconception concerns the cost or the deployment of capital required for international development. Cost and timing are always more than anticipated, and if the franchisor is publicly held, the public market gives little recognition to this upfront investment.

Given the anxious nature of franchisors, the following are eight financial elements franchise companies should consider in developing internationally.

1 **Concept Portability.** Not every concept is portable into countries where the franchisor may desire to expand. Classic cases include McDonald's expanding into India, Wal-Mart expanding into Germany, Starbucks expanding into France and Best Buy expanding into China. While these companies are not all franchise companies, they are major retailers that faced definite difficulties because their concepts did not necessarily fit in the countries at the time of development.

True, the retailers gained momentum since their initial entry, but there initially was a lack of strategic assessment. The franchise company must evaluate its consumers, determine where its concept has been successful and determine the adaptability of its concept. This is what I mean by portability.

2 **A Country Match.** Once the franchisor determines the consumer profile on a global basis, take a deep look at the countries that may have a sufficient demographic match that will allow the concept to gain consumer acceptance. Outside resources can boost this effort, namely people who specialize in global growth. Market intelligence, due diligence and research are the keys to deciding which countries to develop in. Having a good partner in a country does not necessarily mean it is the right country.

3 **Legal Diligence.** Once you choose a suitable country or countries, consider the following questions as to legal due diligence: Does the country have a legal system that is compatible with my expansion plan? Will my legal rights be enforceable in that country? Am I able to protect my concept's intellectual property in the country? Are franchise laws fairly defined in the country? How is money transferred between the U.S. and the country?

4 **Economic Feasibility.** In general, you are creating a new economic model for each country. Everything is based on market intelligence and an understanding of the consumer as well as the supply of goods and services necessary to develop the concept in a country. Consider these questions: Is the cost of real estate acceptable? Do the consumers have enough disposable income to pay for the products or services the franchise is intended to provide in that country? Do the overall unit economics work, including the cost of goods and the cost of labor? Are the goods and labor readily available? Is there price sensitivity or can prices be appropriately adjusted?

5 **Legal Structure.** Franchising is one way to grow internationally; the other ways are joint ventures or corporate stores. Once you determine the suitability of your concept, the right country and economic feasibility, you need a rollout plan. Is the rollout a franchise program, a joint venture, a hybrid, master franchising or corporate stores? I often hear franchising is the best approach, but I am not sure that is always the case. The real issue is availability of funding and management. The key question in identifying the right partners is whether they have expertise in your type of concept, expertise in growth and the necessary economic resources.

There is nothing more important than finding the right partner, whether a fran-

chisee or a joint venture partner. A number of great international consulting groups can find the right partners in the right countries. Make sure your international consultants have specific expertise in the desired countries.

6 **Monitoring the Concept.** Set up a monitoring system that has milestones for what is deemed a financial success. Key questions that need to be addressed are: What is the expected return on investment? What will this development do to the franchisor's valuation? How fast and to what degree is capital deployed? What is the exit strategy, if any?

7 **Development Team.** Whether you elect to use international consultants or hire your own people, the point is to have dedicated resources for international development. I have seen cases where a franchisor partially dedicates a person to international development when that person has spent most of his or her career working domestically. You need to find the right operations, franchise sales and marketing personnel. The international development team needs to be a select team. There can be an overlap of resources, but companies that do well internationally are companies that have dedicated resources.

8 **Funding.** International development cannot be done on a shoestring. It requires its own funding by both debt and equity. The cost and time of the ramp-up is critical. There is no substitution for an adequate working capital. Prepare a detailed sources and user schedule. Recognize that a flow of money coming back and redeployment are not easy and vary by country.

Remember, the key attributes of successful international development are "strategic," "thoughtful," and "economically viable." The attributes to avoid at all costs are "opportunistic," "enamored of a partner" and "stingy with resources."

(Thanks for the information I received and ideas I bounced off Arete Global Partners, a firm dedicated to strategic international development.) FT

Dennis L. Monroe is a shareholder and chairman of Monroe Moxness Berg, a law firm specializing in multi-unit franchise finance, mergers and acquisitions, and taxation. He can be reached at dmonroe@mmblawfirm.com.

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