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When franchising won't do, tap 5 ways to grow

By Dennis L. Monroe

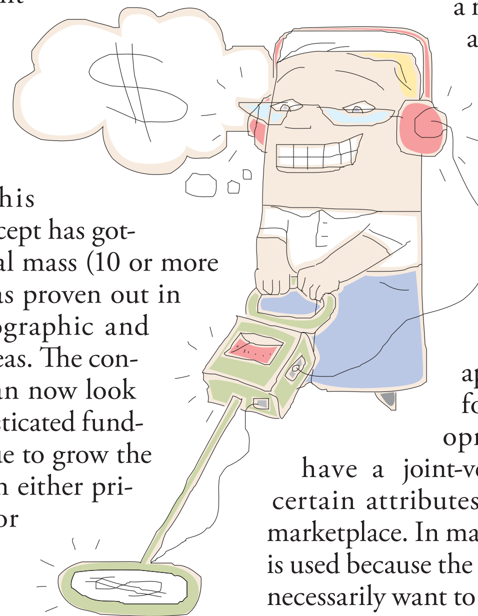
People are always looking for ways to finance growth, but franchising is not effective with all concepts. For example, franchising doesn't work well when a concept is not fully developed, has not been proven with diverse demographic and geographic locations, has not shown consistent performance, or has too many complications.

There are other ways to effectively grow a concept. Let's run through the highlights.

Private equity

The most common way concepts are growing in today's financing environment is through the use of outside equity and a reasonable amount of debt. Equity can appropriately be used:

- To get the first unit open. At this stage equity usually is through friends, family, 401(k) rollovers, second mortgages and any other creative way to provide funding.
- For early-stage growth. Early stage means the first unit of the concept is open and growth is feasible. This stage is normally funded through angels or people who like the first unit; they see the growth potential and want to invest in the ability of the owner. The SBA is also a good source for this stage.
- For second-stage growth. The concept now has between three and nine units (no magic to the numbers) and the owner wants to get to a stage of critical mass to show it is a worthwhile concept. This may be one of the most difficult periods of growth. The concept probably is too early for private equity. The financing option is from individuals who are seeking a growth vehicle versus cash flow. This is normally done through a private placement with a limited number of investors.
- Getting to critical mass. At this stage, the concept has gotten to a critical mass (10 or more stores) and has proven out in diverse demographic and geographic areas. The concept owner can now look to more sophisticated funding to continue to grow the stores through either private equity or a strategic investor.



Joint ventures

Often when a good concept has developed a few stores, the owner will find an appropriate joint-venture partner in order to grow. A jointventure partner can take two forms:

- A partner who is a strong operator but the concept owner keeps control of the concept. The concept owner normally uses a license agreement for the joint venture and controls the development but gives the operator a significant ownership interest. Usually the operator invests money and sweat equity side by side with the concept owner.
- A partner who is a money source and interested in investing in growth in a certain geographic area, but not interested in operating the concept. A license agreement and a management agreement are used.

In all joint-venture arrangements the concept owner needs to use separate entities and a licensing agreement for the name and concept.

Joint venture approaches are common for international development. It is critical to have a joint-venture partner who has certain attributes and understands the marketplace. In many cases, a joint venture is used because the concept owner does not necessarily want to get involved with international franchising.

It is important to clearly define the scope of the joint venture: the number of stores, the geographic rights and how the concept owner purchases the stores back from the joint venture if the owner is contemplating selling the company with a roll-up of concept units.

With a joint venture, it is critical not to step over the lines so the joint venture becomes a franchise (which then requires all of the requisite compliance). This is the

key danger in the joint venture approach.

Straight licensing

Straight licensing is entering into a license for certain intellectual property owned by the concept owner. Again, the concept owner has to be careful not to violate the franchise rules.

There may be minimal control over the licensee, and the owner's rights are usually limited to termination of the license to protect the owner's intellectual property. This can be an effective way to leverage the concept name but not be involved in the actual business of the licensee.

Jim Wahl

The amount charged for the license depends on the value of the intellectual property including the name. The charge is normally half of what would be charged for a franchise royalty.

Employee operator

This approach has been utilized for many years by a number of multi-unit concepts, most notably Outback Steakhouse. The employee- operator model provides the operating parties with a significant interest in a unit as a result of historic efforts and normally a cash investment.

This option should be considered as a possible way to seed various markets and provide incentive for top people to grow the concept. In most cases the operating partner is not going to have absolute control but will certainly have operational control.

Leveraging IP

This is a novel technique being used to expand concepts. Certain financial groups have been acquiring intellectual property of under-performing concepts, or acquiring the closed sites of concepts. The business strategy is to take advantage of historically well-known concepts and to retool those concepts to provide for an expansion vehicle. Also, many closed concepts have good sites that landlords are anxious to re-open with a new concept and provide leasehold financing thus creating another means of accelerating growth for the concept owners.

These are a few techniques that can be used as an alternative to franchising, and they serve as viable growth strategies. FT

—Monroe Moxness Berg partner Jim Wahl also contributed to this article.

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