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How to Bring Value to an Emerging Concept

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As Monitor readers know, emerging concepts are getting a lot of press, particularly because of private equity's investment in earlier-stage concepts. Examples of this type of investment would be Sentinel Capital Partners' investment in Newk's Eatery, Morehead Capital's investment in Hash House A Go Go and Chop't, and Buffalo Wild Wings' investment in Pizza Rev and Rusty Taco.

What do I mean by emerging concepts? An emerging concept has at least two units, has shown some early success, received some degree of following, and is a concept the owner wants to grow. If you have an emerging concept or are looking to invest in an emerging concept, there are some road markers along the way that can bring value and attract investment.

It is difficult to value an emerging concept, because the EBITDA multiple (which is usually applied to restaurant companies) is not necessarily a true reflection of the concept's value. There is an inflection point in the growth of an emerging concept where there has been enough success and some meaningful development of units to indicate consumer acceptance, and some early belief in significant yet unknown future value and a real growth potential.

The following is my view of the road makers for creating value for emerging concepts:

1. Get several stores open in diverse geographic areas. This early approach to development helps assess the diversity of customers who will be the consumers for the new stores and the potential growth. The first two stores should be in one geographic area, and then ideally stores three and four will be in more diverse geographic areas, so long as they are close enough that it will not strain management.

2. Make the growth plan clear to potential investors. One of the questions to keep in mind: Is the growth plan based on franchising, corporate store development, joint venture or a mix? If you look at the emerging concepts that have been acquired recently, most have been acquired with the idea of franchising, or are actually in early stage franchising activities. I still believe franchising should wait until there are an adequate number of stores to really show the success to a potential franchisee.

3. Determine if the concept itself fits into one of the current perceived growth buckets, particularly fast casual or casual with a limited service (using technology and iPads for placing orders and thereby reducing labor). Another growth category would include concepts that have a certain degree of entertainment function, or are aesthetically very appealing.

4. Make sure the emerging concept fits into the right-sized box so that there will be available sites at reasonable rents. Alternately, consider concepts that can fit in non-traditional locations, such as colleges, airports, freeway locations and other places that usually have high volume.

You want to ensure your emerging concept does not only work in an "A" location, because most concepts can work ithere. Instead, the question should be: Can this concept work in a B or C location? Can it inspire consumers to seek out locations?

5. Use marketing to cultivate strong consumer appeal. One of the characteristics we see with emerging concepts (which was originally the case with Chipotle) is the concept begins to develop strong consumer loyalty (or what I would call a "cult following"). It is important the marketing for emerging concepts be somewhat edgy, social media savvy and able to inspire word of mouth. Avoid discounting to attract consumers; strong appeal to consumer sensibilities takes precedence over pricing.

6 Have a clear understanding of your ultimate exit strategy. Are you looking to just grow the concept organically and hold? Or, do you want an exit strategy sooner rather than later? Are you perhaps just interested in the fun of being in the industry?

7. Have a strong board of directors. I like emerging concepts to have board members who are good advisors and have been involved in the grass-roots development process. It certainly makes it easier to attract investment and find potential strategic partners.

The above are some of the key value-building blocks for a successful emerging concept, one that will attract the right type of investor or a strategic partner.

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