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Do You 'Trust'?

10 reasons for franchisors to embrace succession trusts

By Dennis L. Monroe

Two of my partners, John Berg and Scott Husaby, have spent a great deal of time as panelists on the Franchise Times Exit Strategies Seminar Series and have been travelling around the country speaking to franchisors and franchisees on the topic of exit planning. The two have developed a unique trust designed to own franchised business interests. This trust allows the business owner to address exit and succession planning objectives that are otherwise difficult to address without the use of such a trust.

Despite the advantages of this trust structure to both franchisees and franchisors, most franchise systems do not currently allow for trust ownership of franchised interests (or if they do allow for trust ownership, it comes at the cost of having to satisfy potentially onerous conditions).

For franchise systems that have not yet considered the advantages of allowing trust owned franchised interests,here are our top 10 reasons why franchisors should embrace this concept.

1. Provides Business Continuity Planning. One of the most significant blows a franchised business can receive is when an owner/operator dies or becomes incapacitated unexpectedly. Such an event commonly leads to confusion and uncertainty over who will take the reigns of the business. A business succession trust typically provides for this possibility and creates a management structure that can immediately run the business.

2. Addresses Ownership Transition Issues. If the business owner intends to transfer the business to a family member, an insider in the business, or even to a known third party, the business transition trust can implement this plan. Without such a plan, there often is chaos about when and how the business is transferred.

3. Minimizes Royalty Payment Disruption. Since the primary goal of a business succession trust is to ensure the orderly and efficient transition of the business, the odds of the business continuing to operate increase which ensures that the business is able to continue making its royalty payments to the franchisor. We regularly hear war stories from franchisors dealing with the death or incapacity of a franchisee who did not plan for the event. These situations can have an immediate negative financial impact on the franchisor.

Scott Husaby

John Berg

4. Helps Maintain System Standards. One of the obvious consequences of poor franchisee planning is the rapid deterioration of the locations in difficult times. The financial stress put on a poorly planned business quickly evidences itself in poor maintenance, capital expenditures and missed remodeling deadlines. Encouraging franchisees to use business succession trusts can prevent this situation and benefit the overall system by maintaining system standards.

5. Avoids Probate. In most states individually owned franchises end up in probate at the owner's death. Probate is the legal process of transferring title to assets under the owner's estate plan or state law. This can be an incredibly time consuming and costly process. Not only is this a burden on the business owner's surviving family, but it can also be a drain on franchisor resources as the franchisor is in effect partnered with the probate court during the process that can last several years.

6. Minimize Liquidity Problems. Poor planning by franchisees generally results in unnecessary tax consequences at the owner's death. This can put the family in financial crisis and either require a fire sale or the withdrawal of necessary funds that are necessary to the business. The use of a business succession trust, coupled with the appropriate estate plan, can provide much needed estate tax planning at death. Trust planning can also facilitate lifetime wealth transfers to the owner's family that can further minimize potential estate taxes.

7. Franchisee Recruiting Tool. Franchise systems that are proactive in not only allowing, but encouraging, franchisee succession and exit planning are viewed favorably by franchisees. Franchisors who are able to offer prospective franchisees succession and exit planning tools within the system have a leg up on systems that do not. Franchisees are raising this issue today and we expect that this issue will become even more prevalent in the future.

8. Responsive to Franchisee Concerns. We hear from a lot of franchise systems that succession and exit planning are hot topics on their franchisee surveys. Taking steps to help address the franchisees concerns shows not only that the franchisor is listening to these concerns, but that they are willing to do something about it.

9. Allows Franchisor to Control the Process. In systems that do not allow trust ownership, many franchisees are transferring their interests to trusts and not disclosing it to the franchisor. This prevents the franchisor from having any input on the types of trusts allowed or the overall transfer process. Allowing trust ownership provides the franchisor with the ability to dictate what types of trusts will be permitted and the process that franchisees need to follow to transfer to trusts.

10. Provides System Efficiency. By proactively defining the types of trusts that will be allowed and the related transfer process, the franchisor can avoid having to review, comment, and negotiate each franchisee's situation independently. Having rules and standards in place significantly streamlines the trust compliance process and minimizes franchisor resources needed to deal with this issue.

Franchisors have not traditionally been receptive to trust ownership of franchisee businesses. However, many franchisors are reviewing this policy and more often than not are reconsidering their position due to the overwhelming benefits for both franchisors and franchisees. Franchisors that do not get on board may find themselves struggling to retain, maintain and sustain franchisees and their systems.

Investing in this process today will reap financial rewards in the future. FT

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