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Out of Bounds

Smaller firms, too, can expand abroad—with the right partner

By Dennis L. Monroe

The franchise world has embraced international activity for years and regards global expansion as a viable and, at times, a primary opportunity for development. As we know, the IFA is active internationally, and recent trade missions co-sponsored by Franchise Times reflect a growing desire of U.S. franchise businesses to accelerate development outside national borders.

This being said, how does a U.S. franchise business finance international development? It is not an easy task, particularly if you are not Yum or McDonald's. I asked three leading financial experts to provide some insights regarding financing internationally. I was particularly interested in U.S. companies that are not one of the mega-brands, but rather smaller concepts or franchisees that have run out of development territory at home and are looking at international development as a growth vehicle.

The three experts are all financing industry icons: Trey Brown, senior managing director/commercial leader at GE Capital; Nick Cole, executive vice president at Wells Fargo; and Ted Lynch, managing director at Bank of America. Lynch provided me with three great points to start our discussion, which Brown and Cole reiterated. Consider these points when looking at international development:

Feasibility: Can a franchisee or franchisor effectively develop units and get to critical mass in a reasonable amount of time in a specific country?

Functionality: Are the operating parameters of the concept itself (as well as products and delivery methodology) functional for the country?

Legality: What are the legal constraints involved in operating in the chosen country? What are the legal rights for lenders and franchisors concerning collateral and the enforcement of rights?

Cole recounted his experience in a previous life with McDonald's in Brazil. The principals had done a great deal of homework, including vetting legal rights. But even so, a particular operator decided not to pay the franchisor or the lender. Cole said that although McDonald's realized it had significant legal rights, the issue of enforceability (because of the legal environment in Brazil) was highly problematic. If it can happen to McDonald's, we all should be forewarned.

I asked all three experts about using U.S. assets to finance international growth. One recommendation was for a company to use its collateral base and borrowing ability as the basis for providing funds that can be ex-patriated. They all agreed that in today's market if you are an operator with a strong balance sheet and good cash flow, you can use leveraged funds in any reasonable manner. The lender is looking to the U.S. company rather than to collateralizing the foreign assets. They also emphasized the crucial nature of understanding the lending environment in the country and the interplay with the U.S. business. These issues can best be gleaned by talking to your lenders and getting necessary referrals.

Brown said GE tries to keep the lending as local as possible—GE has a strong global commitment with three different divisions that pretty much cover the globe. Keeping it local means the lending stays with the U.S. company with loan proceeds utilized for non-U.S. development. Brown stated a key element is making the equity accessible and then creating the portability. In most cases, even though the collateral may be administered by a local partner or an overseas division, the ultimate management of the credit is done by the U.S. lender.

Next we discussed specific countries. Canada appears to be the easiest country to finance franchise development because of the equality of the currency between the U.S. and Canada and because there is a long-standing history of U.S. lenders enforcing collateral rights in Canada. Mexico is second in terms of the ability to franchise, but is certainly more problematic than Canada. (Mexico's challenges revolve around currency and legal issues.) European, Asian and Middle Eastern countries need to be looked at individually as to whether there needs to be a strong, local banking partner. All three lenders stressed the importance of their local contacts to further enhance the credit administration process.

My takeaway is that each expert sees strong U.S.-franchised concepts' desire to develop globally as being a wave of the future, whether they are franchisee or franchisor. While it's certainly doable, foreign development is not for a company that has marginal financial strength. In most cases,

a company will use U.S. assets, but needs to have a lender who has partners or knowledge in the specific countries. Further, a clear understanding of the legalities of that foreign country is a must to understand both the repatriation of foreign assets, the enforceability of lender rights and the franchise laws and implications.

I have also seen private equity groups looking at investing in foreign operations through their U.S. investment arms. While there are some significant tax implications, private equity remains a great opportunity for franchise systems.

There is no doubt that international expansion is the future of franchising. As we see more smaller companies franchising internationally, the need for creative financing will increase, but so will the need for strong partners, both as operators and lenders. FT

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