RESTAURANT FINANCE MONITOR®

Volume 30, Number 9 • Restaurant Finance Monitor, 2808 Anthony Lane South, Minneapolis, MN 55418 • ISSN #1061-382X

September 18, 2019

Choosing the Right Second, Third or Even Fourth Concept

By **Dennis Monroe**

The Monitor's annual Top 200 franchisee ranking makes it clear that most of the larger multi-unit operators in the ranking operate multiple concepts. This has been a trend for the past 15 years. It's difficult to become a large multi-unit operator and have just one concept. There are all kinds of roadblocks, particularly if you're a franchisee. Your first concept may have oversaturated your market; you may lack development rights; or the concept might not have growth potential.

This being said, there are important criteria in choosing the second, third, fourth or even fifth concept to integrate into a large multi-unit operator's portfolio. Here are eight key principles in trying to figure out what kind of concepts will work for a multi-unit operator.

1. Understand what your organization is good at doing. Are you good at casual dining or QSR? Will you need something that is easy to duplicate and grow, or can you take on unique concepts?

Many QSR operators can easily go into fast-casual restaurants because so much of QSR has taken on fast casual attributes. As for casual dining, operating an upscale concept might be a smart way to stay in the same sector. Bear in mind there have been cases of casual-dining franchisees, particularly in Applebee's, taking on more complex concepts, such as Rio Bravo and Johnny Carino's, that did not succeed.

It seems that fast casual presents a good option for expansion, for both casual and QSR operators. The one caveat may be delivery, which again adds complexity that needs to be understood. Make sure you understand the skillset of your company and make your choice consistent with those skillsets.

2. The profitability needs to be compatible. Even more important than compatibility of concept is compatibility of profitability. If your existing restaurants have strong profitability, say in the neighborhood of 15% store operating profit, you will want to be looking at concepts that have the potential for 15% or higher. The primary reason for this is that a company's culture and mindset are shaped by the internal consensus on what a good concept and a good store consists of, and if you bring in a less-profitable concept it will definitely affect the culture.

3. The initial investment. I like to see companies used to lower capital cost concepts stay in lower capital cost concepts. Similarly, companies involved in higher cost concepts may have a better shot at getting an effective return on higher-investment concepts because of their experience.

4. Is financing readily available? Don't take on a concept that doesn't have a track record of franchisees finding financing. While you may not attract the national lenders, see what other money is available, otherwise I'm not sure it's a concept you should take on. Look for lenders and investors that follow this concept and have it on their approved list.

5. Is the franchise relationship compatible with your existing franchise relationship? Large operators that have had long-term relationships with a franchisor have clear expectations. I can't tell you how many times I've heard, "This franchisor just doesn't get it." That's in reference to an early-stage concept where they're still trying to figure out their development programs and working relationships with multi-unit operators. These early-stage concepts need to be flexible if they're going to attract large multi-unit operators who usually expect a "most favored nation" status. I tell emerging franchisors that these multi-unit operators are larger than they are and thus have bargaining power.

6. Do you have existing management people to plug into this new concept? The management of multiple concepts is the key. While it's often the case that a chief operating officer of a large multi-unit operator oversees a number of brands, I would strongly recommend that each brand have its own operating officer. It's important to have managers trained in the concept you'll be acquiring, whether they're internal people dedicated to that brand, or external hires from within the concept you're trying to develop. Make sure the people operating the newer brands have the latitude to develop the brand and a performance matrix that fits the concept.

7. Understand the exit strategy. Any time a new concept is acquired, you need to be thinking about how to sell it. Large multi-unit operators should look to get involved with concepts that have a franchise community clearly interested in growth. A growing franchise community will offer a variety of exit-plans, or even a franchisor that wants corporate stores. Understand what your exit options are.

8. Make sure that your business is properly structured and protected. I would be remiss as a lawyer not to remind you that not every concept works and not every landlord is cooperative. So make sure you structure your business in such way as to maximize your legal protection. If you have problem stores, place them within their own business entity. If you own some of the real estate, keeping that real estate in a separate entity is always something we advise. Try to limit your personal guaranties on the financing, both at the franchise level and at the real estate level. Proper structure is crucial.

Summary

It's clear the trend for large, multi-unit operators to develop and run multiple concepts will continue. And we can learn a lot from what's happened over the last 15 years. I hope the points I've made here will provide a basis for your future development.

Dennis Monroe is chair of Monroe Moxness Berg, a law firm which focuses on M&A, taxation and other business matters for multi-unit restaurant businesses. You can reach him at dmonroe@mmblawfirm.com, or at 952-885-5962.