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Consider These New Kinds of Joint Ventures

During these tough times for restaurants, there is potential for an adversarial relationship between an operator and his landlords, bank, suppliers, employees and investors. This comes on top of the stress restaurant owners are under to make things work and stay in business. Can these adversarial relationships be transformed into productive, collaborative ones? Here are five thoughts on economic cooperation among the various parties, or what I like to call joint ventures.

Landlords

Landlords are under pressure from investors or banks to keep rents at the previous level. Conversely, restaurants are under pressure to reduce their occupancy costs. One idea I've used is to establish a joint venture with a landlord where the restaurant owner doesn't take management fees or G&A costs at the store level, unless the restaurant makes profit. The landlord also doesn't get rent unless the tenant makes a profit. This doesn't usually apply to real estate taxes or CAM, but just to the overall rent. This creates an alignment with the landlord. The tenant/operator has an incentive to maximize profitability because otherwise they won't get paid. You could also design one where the landlord gets the first profit up to a certain percentage of sales, then the management team gets some profit to pay for their overhead, and the balance is split. Obviously if things work out well, the arrangement benefits both parties.

Another landlord joint venture idea is to ask the landlord to become an investor, so they have a real stake in the restaurant's success, with their interest going beyond just collecting rent. The landlord may provide working capital to be used to pay the rent. Or, they might provide money for capital improvements, You could offer the landlord a preferred class of stock so they get their equity back first.

The third option is to reset the rent on trailing three-month increments for the next three-month increment based on a percentage of sales. This way, the tenant is not overly burdened, but the landlord sees upside when sales increase.

Banks

Banks are a hard sell when it comes to any kind of joint venture arrangement. They are lenders and that is the relationship they want. In fact, sometimes they have a problem if they take an equity interest because of what we call "equitable subordination," where the bank loses its security interest in the assets. That being said, the bank may help facilitate through a related investment fund or it may have an affiliate Small Business Investment Company (SBIC). The bankers may also know potential investors. Also, going to no interest for a period of time may be a form of joint venture.

Suppliers

Suppliers present a great opportunity for a joint venture. First and foremost, they want to get paid for their product, but they also want some assurance there are going to be continued sales, not a quick switch for the lowest price. One of the things I've seen happening more frequently is suppliers loaning money to the restaurant and that money being earned off as the owners purchase items. If for some reason the restaurant isn't able to meet its obligations because of outside forces, then there is an option of time extension or forgiveness. Additionally, you might ask your supplier to invest in the restaurant with the back amount owed.

Employees

The industry is experimenting with service charges, with bringing employees back at different levels and with staffing in general. To provide employees with incentive, why not make them owners? Employees can have actual ownership. They can own restricted stock, meaning that it vests over time. If they're terminated for cause, they lose that right.There can be other protections for owners, such as non-competes. But in general, equity is a good way to get employees involved.

Another option is what I call a "phantom" approach, where the employees share in deferred income based upon the appreciation of the restaurant. If the restaurant is starting off after COVID and has a fairly low value, over time the employees can share in a percentage of the appreciation of that value, typically determined each year by a multiple of EBITDA. This is truly a way to create alignment with your employees and encouraging them to come up with new ideas to help grow the restaurant. They can benefit from that growth.

Existing Investors

You need to be open and honest with your existing investors, especially if there is a delay in getting them paid. There may also be a need for a capital call, or a buyout at a lower price. Also, if for some reason the investors actually have loaned the money to the restaurant in the form of a debt instrument, consider converting that to equity. It cleans up the balance sheet and takes some pressure off the restaurant, plus it may be something of real value.

Key Management

One of the subjects I've written about previously is that a restaurant should be considered more as a concept, rather than just a standalone, in-room dining venue. Following this approach, owners should consider spinning off the intellectual property associated with the concept to a licensing company, where the name and intellectual property is licensed to the existing restaurant entities as well as new projects. This gives employees, particularly the chef and the other creative people, a significant interest in the intellectual property. It may not be a true joint venture approach, but it creates alignment and a sharing of the upside.

In general, today you have to be creative. Look at the needs of your key stakeholders and try to come up with new ideas that will help you stay in business and eventually prosper.

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