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Some Key Ideas to Owning Multiple Concepts

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As evidenced by the Monitor's Annual Top 200 restaurant franchisees, which was published in June, growth in multiple-concept ownership continues to accelerate. In recognition of this trend, we've developed a few key takeaways regarding effective multi-concept ownership from a legal and financial perspective:

1. Separate Entities: Most franchisors require their franchise locations to be in a single-operating (franchisee) entity. That doesn't mean you can't have a holding company up the entity chain, but from a franchise and liability standpoint, we encourage a separate legal structure for each concept you own and operate. This legal structure can also utilize subsidiary or affiliate entities for potential regional development sites, along with different types of stores in development, management companies and/or real estate holding companies. These additional entities are single-member LLCs, which require one tax return filed at the holding-company level and utilize consolidated financials. The key is flexibility to own, operate and, eventually sell separate entities, which may result in a higher sales price.

2. Use of Management Company: One of the material advantages to owning and operating multiple concepts is the opportunity to take advantage of a talented management team at the overstore level. If you have top-flight management in place, you'll likely be able to provide efficient and cost-effective management services to multiple brands. These synergies cannot be overstated. The professional overstore management team can be employed by an affiliate management company entity and charge a management fee at the market rate, so the accounting for your restaurants, and the view of profitability, accurately reflect the true economic success (or lack thereof) of each of your independent concepts.

3. Real Estate: If you are keen on owning and developing real estate, especially if this is for one of your primary investment focuses, you should use a separate entity for acquiring and holding your real estate.

Each concept should have its own real estate entity since the rent will vary with each concept and location. Rent should be at fair market value, but you also want some flexibility to adjust it because your real estate entities will be valued based on the tenant concept and a triple-net lease. For successful concepts, you can charge more rent without burdening with above-market cost, while other concepts will require lower rent. This structure also helps facilitate potential future sale-leaseback transactions, which can be an important financing option.

4. Bank Borrowing: The one issue that comes up with multi-concept ownership is that lenders are reluctant to lend to newer concepts, but will lend to your "better-established" concepts. If possible, keep the lending, cross-collateralization and guarantees separate among your concepts. This can be difficult, depending on how much equity you are putting into the development of a new concept, but many concepts require it and it's usually in your best downside interest to keep your concepts separate. If one concept doesn't work out, you don't want to sink your stronger concept because you've cross-collateralized. In certain circumstances, your well-established entities might be required to provide guarantees for your new-concept entities. If so, make sure those guarantees are fully negotiated with sunset, burn-off or other limitation. Further, your loan covenants should be tracked by individual concept versus overall corporate covenants. Again, you want the loan to stand alone as much as possible so you're able to pay off the loan without having to deal with other unrelated collateral.

5. Equity Investment: Often multi-concept owners will attempt to raise equity for specific concept development. This is a good, nondilutive approach to overall ownership of the enterprise. It can be tricky, however, because sophisticated investors might be seeking a piece of the entire enterprise, not just the new development. If this is the case, consider issuing options or warrants for future value in the overall enterprise, but try to keep as much of the new investment at the concept level. There's a lot to unpack here, so we encourage you to seek legal and accounting counsel for all capital raising transactions.

6. Employee Compensation: We encourage our clients to compensate employees at the appropriate entity level, rather than at the overall enterprise level. Certain employees, such as your director of operations and key marketing people, should be compensated at the management company level, but the store managers and other store-level employees should be compensated at the store levels. An incentive idea to keep talent is to offer stock (or membership) appreciation rights. Essentially, key employees have an opportunity to receive part of the value increase of their entity. It's not actual equity ownership (it's a contractual right) and it's fully tax deductible when paid and is taxed as ordinary income to the employee as deferred compensation. Payment is made upon a triggering event, which is normally a sale of the company, termination, retirement, death or disability of the employee.

7. Exit Strategy: One of the major advantages of this multi-entity structure is options upon sale. You can sell assets, stock (membership), a concept, the real estate or any combination. You can also retain the real estate. The key is flexibility, optimum price and tax savings.

8. Franchise Documents: In light of the above, one final takeaway is the negotiation of your franchise and development agreements. Make sure your intended structure is allowed under these agreements. Be mindful of rights of first refusal and cross-defaults. Make sure you have a clear delineation between your entities regarding the various franchisee entities. Try to avoid the typical affiliation language.

In conclusion, the trend toward multi-concept ownership will continue as owners and operators continue to attract sophisticated, top-flight officers and managers who want growth. Make sure your structure is the right fit for what you're trying to accomplish, your tax structure is correct and you have the proper structure to maximize value upon an exit when the time is right.

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