ACHIEVING A SUCCESSFUL REFRANCHISING PROGRAM:

A TOP TEN LIST FOR SUCCESS

The sale of corporate stores to franchisees ("refranchising") has been an effective tool for many franchisors to raise cash for debt reduction, acquisitions, brand expansion and new development. The franchisor also benefits from additional royalty streams and new development agreements with its franchisees. In return, the franchisee is able to enter a business with an established brand and a built-in infrastructure, which typically translates, to lower risk. With a properly implemented program, both franchisors and franchisees prosper from jointly developing the brand and increasing its profitability.

However, if the process lacks skillful execution and support, a franchisor could be creating its own worst nightmare. Such disasters as securities fraud litigation, brand instability and franchisee defaults are just a few of the potential pitfalls of refranchising. Additionally, the negative publicity of franchisors and franchisees pointing at each other for their lack of success only serves to distract executive management's focus and attention which in turn can create a loss of corporate morale, diversion from growth strategies and, in extreme cases, stagnation of the brand or even bankruptcy of the system.

Many existing and potential franchisors have explored the benefits of refranchising only to be frightened off by the negative experiences of previous refranchising attempts or from the horror stores of other franchisors detailed in the business news. Thus, any company considering a refranchising program should consider this Top Ten list of successful tips before proceeding:

1. **Achieve consensus and support of executive management.** Management should first create clear goals and objectives as to what it wants to achieve through refranchising and set a realistic timeframe in which to accomplish these goals. If all divisions of management are not fully supportive of the process, it will lack the critical cooperation of key individuals that could undermine the process. Additionally, a franchisor needs to ***devote adequate budgets, resources, and time to this program***. Unless a company shows its commitment and support to this program, it will create a negative perception of its process and will not attract the necessary buyers or lenders critical to its program. These problems will create unnecessary frustration and time delays that usually result in a franchisor prematurely abandoning its program or throwing good money after a bad process.

2. **Create a specialized M&A team**, either in-house or outsourced, to run the program and select the head of this team to be a decision-maker that can make commitments on behalf of the company. This team should include experienced financial, legal and operational experts with the sole responsibility of creating a successful refranchising program. If existing divisions absorb refranchising responsibilities, it may lead to a lack of focus.

These divisions are already busy with their primary functions and will be less effective in trying to take on additional responsibilities outside their expertise. Additionally, divisions without experience or training run the risk of financial and securities liability issues unique to this process.

3. **Analyze and research prior refranchising programs.** Any company considering this process should study not just the successful programs of other companies but what went wrong in the unsuccessful programs. Your company should learn from these anecdotal cases and apply these lessons to its concept.

4. **Strategically plan and analyze what assets should be marketed.** The refranchising team should use the goals and objectives set forth in Step #1 to determine what assets or markets should be sold. The final balance of corporate-owned vs. franchised units should be determined by your company based its own operational, strategic and financial parameters.

5. **Set pricing by using appropriate valuation tools.** Valuation models should include reasonable assumptions and should also reflect the financial ratios and return analysis that your buyers and lenders will be taking into consideration. The use of unrealistic assumptions will slow down or eliminate any hope for price agreement or loan approval while greatly improving the probability of franchisee defaults and bailouts in the future.

6. **Create a deal step process that includes the input and consensus of all divisions.** Your refranchising team should seek the input and advice from every division of your company in order to create a process that will insure a smooth transition. The cooperation from your legal, financial, marketing, operations and human resources division are critical in avoiding unnecessary disruptions, problems and liabilities. This process should include detailed procedures, checklists and reporting forms for each division affected by refranchising.

7. **Create a pool of qualified buyers.** Analyze what type of buyer would be a good fit for your concept and determine what financial or operational criteria they would have to possess before you would approve them to be a part of your system. Your brand will be impacted by the quality of your new franchisees. Accordingly, selection of buyers is a critical concern and requires a significant amount of due diligence on your part. After completing this list, begin a targeted marketing and advertising program designed to attract their attention.

8. **Establish dedicated lending programs for your buyers.** Adequate disclosure about your brand history, current operating performance, future potential, marketing and operating strategies, competitive conditions and other

relevant factors will help a lender to develop a suitable program for your franchisees. This will eliminate the need for repetitive due diligence by lenders and promote faster "cookie-cutter" deal closure.

9. **Provide real support and services to your franchisees.** Earn your royalty payments by giving franchisees the tools necessary to be successful in your system. The development of training programs and seminars that inform new franchisees about your system are imperative for the long-term success of your brand. Additionally, on-going programs are essential to maintaining the quality of your franchisee operations. Pass on savings created by the leverage of the corporate franchisor whenever possible. If a franchisor returns value for its royalties, it will only increase the value of its own markets and strengthen the loyalty and financial stability of its franchisees.

10. **Conduct annual audits of the franchisee and your process.** Find trouble before it finds you. If a franchisee is experiencing weak performance, take active steps to formulate a joint solution before it spreads to the entire system. Also, determine if your process helped create these problems and make the necessary corrections before they are repeated with other franchisees.

While no Top Ten list can be comprehensive, these basic steps will create a foundation for a successful refranchising program. If a franchisor will consider the long-term effects of its refranchising program as opposed to just its short-term gains, it will ultimately grow its brand and profitability. Franchisors should remember that they are in a long-term relationship with their franchisees. If the franchisee is successful, the franchisor will reap the benefits of positive publicity, increased retail development, increased royalty streams, new ideas and lower costs. Just like any relationship…..you get back what you put into it.

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