



Maintaining Franchisee Profitability, System Growth in a Downturn

Focusing on franchisees' success and capitalizing on growth opportunities, franchise systems can be better positioned to grow faster during the recovery.

BY ERIK MORRIS



Title a book "How Franchisors Can Thrive During the Next Economic Downturn" and it's sure to be a best seller, not to mention the talk of the town at International Franchise Association conventions for many years to come. Unfortunately, no such reference guide exists.

However, as a private equity firm working alongside experienced management teams of multiple franchise systems in our portfolio, the past two years have provided a unique opportunity to learn certain best practices to ensure success in even the most difficult circumstances. Following are some potential lessons learned for the franchise community to consider that may help industry professionals be better prepared for recovery following an economic downturn:

Keeping an Eye on Unit Profitability

- **Quickly Identify Struggling Owners:** A crucial first step is making sure the corporate team can recognize the warning signs of struggling franchisees. Advance notice allows you to put plans in place before the situation gets so bad it is too late to make a difference. Sometimes the warning signs are obvious, such as requests for royalty relief. Other signs are more subtle, such as lifestyle downsizing, which can only be noticed by building and maintaining close contact and relationships with the franchise owners. For example, Fast Signs recently moved to a decentralized franchise support structure. Face-to-face meetings with franchisees increased by 100 percent, and as a result, the company has intimate knowledge of individual franchisees' needs and can adjust support accordingly.

In addition to being able to provide them with timely support, when times get rough, it's critical that the corporate team be aware of which franchisees will need the most help. The role of franchise business consultants is extremely helpful in identifying the most-struggling franchisees, and guiding them to instill best practices that will help prevent dire situations. Reviewing P&Ls and sales reports regularly, seeing how the retail unit is maintained and discussions with landlords can all provide important insight into potential warning signs.

- **Proper Tracking Systems:** Often franchisors are measuring "apples to oranges" when comparing stores because franchisees keep track of their financial data in different ways. Setting up a system that accurately measures unit profitability system-wide is vital to make accurate comparisons. One of our portfolio companies, Moe's Southwest Grill, recently implemented a standard system-wide profit-and-loss accounting format. The system knew the task might be challenging, so they worked



with the franchisee advisory council for nearly a year on finding a solution that offered benefits to everyone. In the end, the new system is accurate, uniform and meets the reporting needs of all parties. With new reporting systems in place, franchisees can now compare their data to other restaurants to find opportunities for improvement. For instance, a franchisee can compare things such as labor costs to the system averages, investigate the reason for any variance, and make any necessary changes as a result.

- **Reduce Real Estate Costs:** The real estate market was one of the hardest hit during the recent down economy, and also provided a unique opportunity to negotiate better lease options with landlords. Doing so, as well as looking at smaller footprints, can have a profound positive effect on franchisee profitability. A number of Roark's portfolio brands helped franchisees understand the best way to approach landlords.
- **Highlight Successful Franchisees to the Entire System:** High-performing franchise owners can be a franchisor's strongest ammunition during tough times to set examples for the entire system to follow. There's no better time to showcase their success than during a downturn. Spotlight these franchisees through a "Q&A" success corner in your monthly newsletter, ask them to speak on conference calls or initiate discussions in chat rooms. One of our portfolio companies, Money Mailer, regularly shares their top-performing franchisees' success stories via case studies, available on their intranet. Seeing these stories firsthand resonates well among peers, who are inspired to model the successful behavior.

System Growth

While franchisors are looking at the steps above to ensure unit profitability, it's also important that they don't lose sight of growth opportunities for the system. A franchisor can't afford to wait to grow until the economy recovers. While record growth isn't likely, certainly there are steps to encourage the growth process during a downturn. These include:

- **Sweeten the Deal:** Steps like reduced franchise fees, discount programs and royalty abatements are common in a downturn, for good reason. Many franchise systems introduced programs to reduce royalty fees for new franchise owners during their first 12 months in operation, if they signed by a certain date. To encourage growth in current under-penetrated markets, Primrose Schools, for example, offered to reimburse potential franchise owners up to \$35,000 in relocation expenses for any owner opening a new school more than 100 miles from their current home. The company also introduced a leasing program that significantly cut up-front real-estate costs. Both measures led to deals that otherwise would not have come to fruition in the economic climate.
- **Alternative Financing Options:** When the credit crunch hit, the franchise systems that had created alternative and reliable financing sources were able to close deals. Tips include finding multiple sources of financing, providing the tools franchisees need to develop their own financing request package and taking an active role with lenders. A franchisor's involvement with lenders can help them make the loan or close the equity gap that is a common problem these days, as underwriting standards have tightened.
- **Encourage Conversions:** During rough economic periods, independent-business owners feel the pain as much as anyone. Down economies are perfect times to ramp up conversion programs. Sell independent-business owners on the benefits that come with being associated with a national, well-known brand. Independent owners will immediately profit from increased buying power and the ability to offer clients a larger variety of products and services. It is important to highlight to the independent owners that they will also benefit from having the support of the corporate office, knowing that the staff there is continuously monitoring trends in the industry and is able to develop innovative new programs. At Fast Signs, its first conversions saw

incredible sales growth. This story was highlighted to other owners, and conversion sales and interest overall in the program have increased meaningfully as a result.

- **Backlog of Leads:** Don't give up on your backlog of old leads. While it may not be time for the hard sells, it's critical to keep the relationships going with your prospects, so that when times do improve, they are more easily converted to sales and your franchise opportunity is still high on their radar.
- **New Opportunities:** Even though it might be easy to focus on the core product when the economy is down, franchisors should be constantly looking at new revenue streams that can contribute to unit-profitability. Approach the issue by thinking differently. Can new products or services be added to the mix with minimal investment and high return? Do new audiences exist that aren't currently being targeted? Batteries Plus, for example, introduced a dealer program in which they partnered with local hardware stores in smaller towns to sell their products in a 20-foot by 24-foot center located within their stores. This provided a unique opportunity to create a presence for the brand in certain markets that would not support a full-fledged franchise.

While tough economic times can prove challenging in many ways, they often also present unique opportunities. By focusing on our franchisees' success and capitalizing on growth opportunities available due to the downturn, the brands we represent are better positioned than ever to grow even faster during the recovery. Partnering with experienced management teams taught us that. ■

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