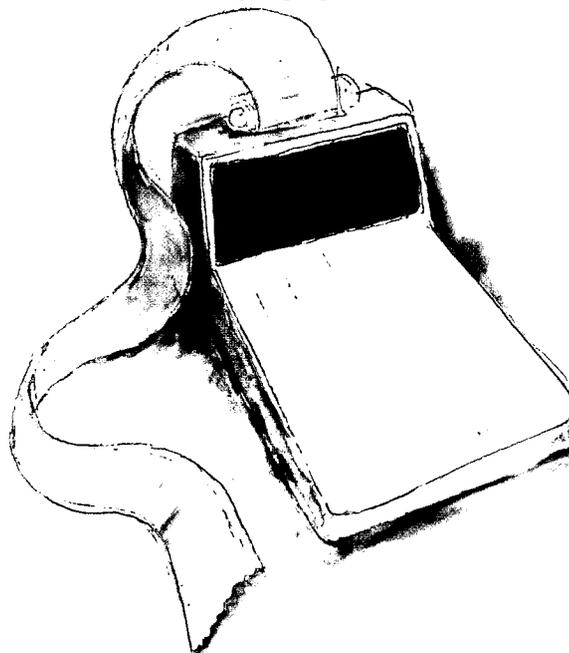


How Acquisitions Affect Franchisees

By Art Coley



How do acquisitions affect franchisees? This question will be addressed much more frequently by management teams from both buyers and sellers as acquisitions become more common. Companies that franchise have caught the attention of private-equity firms, investment bankers, multi-brand franchisors, and Fortune 100 companies like Home Depot and UPS. Bottom line—the franchise method works and it's attracting new investors and capital. Smart management teams will look deeply into how the acquisition will directly and indirectly impact franchisees if they want to create the most value.

Why is the question important?

Why is it so important to fully understand how an acquisition will affect franchisees? The question almost seems too obvious to answer. After all, who is the group that will most help investors or a management team build future value of the brand? The answer: existing franchisees.

Operating a business continues to grow more competitive.

The first obligation of management is acknowledging that the franchisees are stakeholders in the company. Seeing franchisees as stakeholders means that management will look at more than just maximizing shareholder wealth. They will recognize that franchisees' interests and well-being are vital to achieving the overall objectives.

A multi-brand franchise system was recently approached by an investor group wanting to acquire one of the brands in their portfolio of franchised companies. Though ready to make the deal, the franchise organization required one more step: host a meeting with all the current franchisees,

present the offer and have them decide if they wanted the brand sold or not. Though not shareholders in the company, the franchisees decided they wanted to remain with the current owners and not have the system sold. The brand was not sold.

That may be the ultimate illustration of viewing franchisees as stakeholders, and certainly a step that circumstances won't always allow to take place. But it does set a standard and a mindset that includes the concerns of franchisees, who have in some cases pledged savings, home equity, retirement and livelihood to join a system.

What's in it for me?

The number one question franchisees are asking from their new owners is, "How does change of ownership affect me?" There can be numerous benefits for franchise owners that result from an acquisition where management views the franchisees as stakeholders from the beginning. Below are some of the ways that franchisees might benefit when the right buyer hooks up with the right system.

Knowledge. According to a recent study of UFOC data conducted by FRANData for the IFA Educational Foundation, some two-thirds of all franchised brands have less than 100 units. That's a long way from national presence. The simple truth is that most franchise companies today are lacking some combination of knowledge and resources on how to grow their system to the next level. Brands

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don't simply stay in one place and then get set on cruise control. They are born, grow, mature and can even die without the right knowledge and systems.

Investment dollars. In every system today, franchisees have that "wish list" of advertising programs, sales training, field support, new products and services, and more that they know would help them grow if developed and implemented by the franchise system. The reality is that this "wish list" takes money to deliver. Often the current ownership has already been through the pressure of taking tremendous risk starting the system and reaching the point of success where they are now hesitant to risk equity in an attempt to move the brand to the next level, especially if lacking in experience of growing and managing a larger system. An acquisition can result in the supply of fresh capital to revive a system and move it to the next level.

Marketing and Advertising. Operating a business continues to grow more competitive. If an acquisition can bring to the table programs like direct

mail, telemarketing, Web optimization, print advertising, and broadcast media in a way that produces qualified leads and traffic for franchisees in an efficient and effective way, increased sales and profits can be realized much sooner than expected.

Targeted Training. Franchisees continuously have to learn new skills, regardless of the type of franchised business. When the acquiring company can offer targeted training that franchisees need, almost overnight a new sense of excitement and passion is felt throughout the system.

Coaching and Field Support. Although not intentional, there are too many systems today not providing enough support or the right kind of support for franchisees to grow. When new ownership is able to provide properly-trained support staff with an effective ratio of support staff to franchisees, someone is there to not only help them, but also to hold them accountable for following through with commitments they have made. When

franchisees are setting goals and being supported and challenged to hit them, results are much more likely.

Technology. If the franchise company is not using the latest technology to communicate and manage information, there could be major inefficiencies that silently drain time and money from both the franchise system and franchisees. This is an area where an acquisition could make major improvements by coming in and updating the technology throughout the system.

Areas of Concern

Looking at a balance sheet one finds both assets and liabilities. Acquisitions are no different. Along with hopefully a long list of benefits, there will no doubt be challenges and changes that everyone has to be prepared for.

Loss of "family feel." In situations in which smaller systems are being sold by the original founders, franchisees may experience a tough time transitioning into an organization less emotional about the business and more focused on

THE INTERNATIONAL FRANCHISE ASSOCIATION OMBUDSMAN PROGRAM



The IFA and Self-Regulation

The IFA Board of Directors, after two years of in-depth examination of ways in which to improve and strengthen the IFA Code of Principles and Standards of Conduct, has adopted a comprehensive self-regulation program. The key components of the IFA's Self-Regulation program are:

- A Code of Ethics that is stronger and more clearly stated
- An Investor Awareness and Education Program
- A Franchise Compliance Education and Training Program
- A Code Enforcement Mechanism
- A Reward and Recognition Program
- An Ombudsman Program

The IFA Ombudsman Program: A Key Component of Self-Regulation

The purpose of the IFA Ombudsman program is to:

- Enable franchisors and franchisees to identify disputes early and to assist them in taking preventative measures
- Assist franchisors and franchisees by facilitating dispute resolution and recommending non-legal methods and approaches to resolving disputes
- Encourage franchisors and franchisees to work together to resolve disputes
- Provide confidentiality throughout the process
- Provide objective and unbiased advice and guidance to all of the participants

"The IFA Ombudsman Program is an opportunity for franchisees and franchisors to confidentially resolve disagreements with the aid of a fair, impartial and highly trained individual or panel. It is another example of the progressive thinking of the IFA and its commitment to self regulation."

Steve Hammerstein, President and CEO, International Center for Entrepreneurial Development and Chair of IFA Self-Regulation Task Force

**For additional information, contact the IFA Ombudsman at (888) 452-0303 or visit our Web site at www.IFAresolve.com.
For information about the IFA Self-Regulation Program, contact IFA at (202) 628-8000 or www.franchise.org.**

growth of new locations and system sales. This doesn't mean it's a bad thing, just something to be ready to address.

Never underestimate the possible result from the departure of a powerful leader.

Charismatic founder. How close are franchisees with the current ownership and what will happen when the current owners of the brand are no longer around? Of particular importance is that dynamic leader and founder. The absence of one strong personality could leave a void too big to fill. This could result in little to flat growth and even a possible decline. Never underestimate the possible result from the departure of a powerful leader as a consequence of the acquisition.

Change of vision and strategy. It's very likely that the new ownership will establish new direction and plans for the brand. Of course, the more franchise owners are included in this process the

better this will be received. Franchisees being excluded from this process might be a sign of trouble ahead.

Uncertainty about the buyer. Buyers who wait too long to meet with the existing franchisees are inviting speculation, rumors and potential ill-feelings regarding the acquisition. For most franchisees, their business represents a significant part of their lives today and in the future. They shouldn't be expected to be patient in regards to meeting the management that will be responsible for the direction of the brand.

Nearly 1,000,000 reasons

With the growth rates in franchising continuing to explode, it won't be long until there are more than one million franchises in the United States based on information contained in the International Franchise Association's economic impact study conducted by PricewaterhouseCoopers. In 2005 alone, 200 companies decided to start franchising, according to FRANData estimates. This year, more than one million individuals will explore

franchising according to "Street Smart Franchising" authors Don DeBolt, Joe Mathews and Deb Percival and many will take the leap, sign an agreement, and open their business. For some, this will be the biggest decision of their lives. Management teams have to be obsessed with the question of how an acquisition will benefit franchisees. This should be considered an obligation to the franchisees.

Steve Hammerstein, CEO of the International Center for Entrepreneurial Development, had this to say regarding companies acquiring franchise systems: "A good acquirer will be most concerned with what additional benefits will be offered to existing franchisees to help them grow their business. It's even more important than the price paid." ■



Art Coley Jr. is the CEO of the home-based group for the International Center for Entrepreneurial Development, a multi-brand franchisor. He can be reached at acoley@iced.net.

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