FRANCHISE FINANCE

How 9 franchisors help operators find capital

Written By
EDDY GOLDBERG

Franchisors offer all kinds of assistance to help franchisees find funding. Among those we spoke with, the most common types included waiving or reducing franchise fees and/or royalties for the first year or more; connecting franchisees with approved banks and other lending sources that have already vetted the brand; and offering discounts and financial incentives for additional units and accelerated openings. Simply put, lenders want to lend, franchisors want to grow, and franchisees want to start their own business or expand the one they have.

"It's a three-legged stool: franchisor, franchisee, and bank. They have to line up," says James Short, executive vice president and director of food franchise finance at BBVA Compass. "If I were a franchisor looking for new franchisees, there are things I'd want to think about, the same criteria banks look for." These include asking the following questions:

1. Are they a true restaurant operator or a private equity firm or investor that needs one?
2. Does the new franchisee have the back office personnel to facilitate additional growth? Do they have the finance, real estate, HR, and operational capacity to handle it? Or the ability to grow their back office and operational sides?
3. What segment does the franchisee have experience in? For example, are they a QSR operator looking at a casual chain? "We've financed QSR operators into casual, but we require an operating officer with experience in that new segment so the operator doesn't have a 1- or 2-year learning curve," says Short.
4. Do they have development experience, or someone on their team who is a chief development officer type? If a franchisor wants a franchisee to build 20 or 30 units in the next 5 years, they first must feel confident that franchisee can find the financing to do that. "We'll look at the development agreement and the capex schedule hand in hand, and make a determination as to whether they have the capability and capacity to adhere to that development schedule," he says.

As for size (see sidebar), "While we primarily focus on larger national and regional brands, we are willing to finance local and smaller brands if we have the right operator and that brand is relevant to the geography in which they're operating," says Short. This runs the gamut from SBA financing for single-unit operators to multi-bank syndicated finance for 100-plus unit operators; and for purposes that include enterprise franchising, real estate, refinancing, acquisitions, remodels, and new unit development.

Asked for his take on the current franchise lending environment, Short cited a few potential headwinds. "Are we getting to a peak in the economy where discretionary spending and consumer sentiment will be affected?" He's also keeping any eye on new

James Short, BBVA Compass

A day in the life at Tough Mudder Bootcamp

development feasibility. Because so many restaurants have been built in the past 8 years, he looks at where new ones are proposed to see if the area is overbuilt and can support additional restaurants. Minimum wage hikes, he says, have significantly affected many state and local businesses and will continue to squeeze margins and increase the percentage of labor costs, leaving operators no choice but to raise prices. However, he says, in today's economy, will consumers be willing to pay?

A&W RESTAURANTS

A&W, which celebrated 100 years in business in 2019, offers reduced royalties for new franchisees and an incentive program for existing ones. Under its Second-Century Growth Incentive program, A&W offers a "stair-step" royalty program starting with a reduced royalty of 2 percent for the first year, with 1 percent increases each year until royalties reach 5 percent.

"It could be worth up to $50,000 or more over 5 years, based on what their sales are," says Paul Martino, president and COO of A&W Restaurants. "It allows for these folks to get started the first 3-plus years."

As an older brand, A&W has third-generation operators, with a single unit in the family for 40, 50, even 60 years. "Now their kids are growing up and we're providing an avenue not only to transition to their children, but also for them to open additional restaurants to pass on," he says.

Historically, most of the brand's franchisees have been single-unit operators, but that's changing. About 60 percent of A&W's recent growth has been organic, he says, with existing franchisees adding units and new franchisees looking to start with 3 or more units. "This is a shift that needed to happen," says Martino.

Over the past couple of years, A&W has started to focus on helping those single-unit legacy franchisees build the infrastructure to handle growth. To help get them organized for potential multi-unit development, he says, A&W has partnered with some financial service providers and advisors expert in structuring, financial support, and guidance. This initiative includes finding the best financial fit options to secure funding for expansion.

"We're not experts in financing, so we've found partners to work with them to find the best deal," he says. "First and foremost, it's important that these third parties understand our business, and then provide support and guidance to our franchisees." The same holds for banks, he says, which have to understand the business before they feel comfortable enough to lend.

"We're positioned to do 10-plus new restaurants this year and 20 or so next year," says Martino, adding that A&W is not pushing to grow too rapidly as it builds for the next 100 years.

GOLDEN CORRAL

"With the continuing escalation of costs, we recognize the need to help our existing franchisees by reducing our initial franchise fee to help on the up-front development costs. Instead of $50,000, we reduce it to $15,000," says Van Ingram, vice president of franchise development at Golden Corral. "It's strictly for them and a nice incentive that has been well-received by operators, who recognize that we are participating in the up-front costs," such as permitting and development fees.

One caveat: time. After paying the $15,000, franchisees have 18 months to open. After that, the $35,000 kicks in. "We have the option to extend the timeline, and we will if they're close," says Ingram.

The program has been in place for just a few years and is reviewed annually to see if it will continue. So how is it working? "Our existing franchisees have responded very well, opening 8 to 10 per year, and all qualified for this incentive," he says.

One thing Golden Corral does differently is to have a long-term, in-house finance specialist who works with both franchisees and lenders. At most brands, says Ingram, that role usually is filled as an offshoot of another department, or franchisees are pointed to a list of lenders who have worked with the brand before.

Julie Davis at American Dairy Queen

At Golden Corral that person is Sam Starling, vice president of special financing, who's been with the brand for nearly 30 years. In our "Challenge the Pros" article elsewhere in this issue, Ingram says, "Sam maintains relationships with an approved list of more than 40 lenders whom he uses to assist franchisees in creating a financing plan tailored to their individual business needs." Starling also is actively involved with franchisees and lending institutions to restructure debt.

Ingram emphasizes that the reduced fee does not reduce the training and support provided. Franchisees still get all the usual support in critical start-up areas such as real estate, construction, and operations.

For legacy brands like Golden Corral, or any mature brand, says Ingram, a little education and updating is needed when longtime franchisees look to expand. "A lot of our franchisees have been in our system 25 or 30 years and may have not developed a store recently," he says. "Things have changed. Zoning and permitting are now so much more difficult."

There's also the size and complexity of financing a Golden Corral. The average investment, he says, is $3.5 million to $5.5 million, with a 10,000-sq.ft. building, a large parking lot, a kitchen to cook 150 items, and seating for 400. Having an in-house financing specialist goes a long way to making deals happen.

DQ GRILL & CHILL

This past February, American Dairy Queen (ADQ) unveiled four new incentive programs intended to motivate current and prospective franchisees to open more DQ Grill & Chill restaurants. ADQ is targeting 10 major metropolitan markets across the U.S. this year and next. The programs are designed to reward franchisees for on-time development, with bonuses for meeting—and beating—the opening schedule.

1. Timeline incentives. A fixed incentive payment of $30,000 if franchisees open a new DQ Grill & Chill restaurant within 32 weeks from the date of the consent letter; those opening within 40 weeks receive $15,000.
2. Multi-unit opening incentives. Franchisees who open multiple DQ Grill & Chills within the same calendar year are eligible for an additional $10,000 per opening.
3. Year-on-year incentives. Franchisees opening new DQ Grill & Chills in consecutive years are eligible for an additional $10,000 on their first opening in the second calendar year.
4. Re-purpose incentives. Franchisees that develop and open a DQ Grill & Chill by expediting the conversion of a closed, former DQ, or other QSR restaurant facility are eligible for $10,000.

The thinking behind this is to "keep the ball rolling," says Julie Davis, ADQ's director of U.S. franchise sales and development, who joined the company last October. "It aims to keep franchisees focused on incentives, to encourage today's growth, and carry over for future years."

This program marks a shift for the brand, which was founded in 1940. "Our legacy operators were mom-and-pop," she says. "As business has become more sophisticated we're looking for multi-unit and multi-brand operators."

Finding cooperative lending partners is not a problem for the nearly 80-year-old brand. "We're not a finance house, but with all our experience building Grill & Chills for the past 20 years, the unit economics are well established, and we have lenders come to us to be on our preferred lender list," Davis says.

FAZOLI'S

Fazoli's offers franchisees a development incentive that includes a guarantee of at least $125,000 in savings for franchisees who develop at least three locations. Franchisees developing more than five locations will save more than $200,000. Initial franchisee fees are reduced depending on the number of units, and royalties are reduced 2 percent during the restaurant's first year open.

"We've put a little twist on a typical incentive, adding that guarantee," says Doug Bostick, senior vice president of operations and franchise development. "After the third one is open for a full year, we go back and calculate the savings through royalty reduction and initial franchise fees," he says. "If they didn't realize the guaranteed savings, we'll either write a check or reduce royalties some more."

So far, so good: "If anyone falls short, we offset it. We haven't had to do that yet, thankfully." This is the second incentive Fazoli's has rolled out in the past 4 years, and has no set date to pull it back.

As for financing, "We really have only one preferred lender: we recommend ApplePie Capital," he says. "We offer it as a service to our franchisees." He's brought the company to franchisee conferences to speak directly with operators. ApplePie has worked not only with new franchisees, but also with existing ones to finance remodels and upgrades of their POS systems, for example. In the past six months, Fazoli's also has begun working with Boefly, looking to leverage its connections with hundreds of lenders.

However, he says, "There hasn't been as much of a need for the groups we've been talking to in the past 5 years." Why? "We've

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