THE ROLE OF

FRANCHISE RELATIONS IN

MERGERS AND ACQUISITIONS

Franchise Relations Committee
Barbara Moran-Goodrich, Chairman

Committee Co Chairs

Bruce V. Bloom, CFE
Professor William S. Vincent

Contributors:
Bruce V. Bloom, CFE
Professor William S. Vincent
Jack Pearce, CFE
Tom Baber
Mitch Cohen
Catherine Monson, CFE
David Steinberg
,

International Franchise Association
1900 K Street, N.W., Suite 700
Washington, DC 20006
Tel. (202) 628-8000
www.franchise.org

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OVERVIEW – THE ROLE OF FRANCHISE RELATIONS IN MERGERS & ACQUISITIONS

The International Franchise Association's (IFA) Franchise Relations Committee is dedicated to developing information and programs that promote positive franchise relations and encourage dialogue and cooperation between franchisees and franchisors. It is with this purpose in mind the following publication was created to further promote these ideals of excellence and education.

The IFA represents over 1,100 franchise organizations operating within a variety of industries, segmented further into a vast array of vertical markets, and all located within a kaleidoscope of geographic and cultural environments. With all this diversity it is no wonder there is no single strategy for growth and development within the industry. As franchising has matured the practice of mergers and acquisitions, venture capital investments, family and partner successions have all grown substantially as growth and ROI strategies.

Given the importance that franchise relations, confidentiality, trust, transparency and well planned communications play in the Mergers and Acquisitions (M & A) process it is not difficult to understand why there must be a major emphasis on the "best practices" in franchise relations The purpose of this report is two-fold; (i) to discuss the impact of franchise relations in M & A activity and (ii) to present suggestions for "best practices" to be considered in effectively managing franchise relations during the M & A process.

What is the definition of M&A?

Understanding that franchise business model is built on the idea of "independently owned and operated businesses," it is no surprise there is a robust number of ownership changes and succession happening at any given time on the franchisee level. In addition, on the franchisor level the franchising business model stimulates an environment of rapid brand development, wide spread geographic distribution and in-depth market penetration. All of these factors contribute to the use of mergers and acquisitions as an alternative growth strategy.

M & A activity has become an increasingly important event in the franchise industry. Examples include the acquisition of a franchise system by strategic buyers, private individuals, minority ownership, private equity, the franchisees themselves, family members, etc. Reasons why a franchise company would consider an M & A strategy include slow internal organic growth, faster growth during slow economic conditions, a financial strategy to gain market share, cash flow or other objectives, a "roll-up" strategy in a fragmented market segment, succession of ownership among family members or partners, among other reasons.

The McLean Group tracked more than 300 private equity firms that have invested in franchising and are active in the market. "Almost all of these firms are looking for additional brands in which to invest. In 2014, at least 20 deals were completed in the franchise industry by private equity firms. Valuations for these franchisors generally have been considered to be at a "premium" – or at least at levels considered above average M&A deal valuations in the middle market (i.e., many franchisor transactions are completed at high single-digit, if not double-digit EBITDA multiples)."

<u>How Can Franchise Relations Impact M & A Activity</u>

Individuals, companies, investors, private equity, etc. have all become increasingly sophisticated in their knowledge and understanding of the franchising model. Typically, a number of factors will impact the value of a franchise system including the perceived brand value, cash flow (EBITDA) being generated by the franchisor, unit level economics of the individual concept, past growth, future growth opportunities, potential synergies where a strategic buyer is involved, asset value, etc.

The acquirer will also evaluate the franchisor's current and past relationship with its franchisees. Among the issues to be evaluated include;

- How much past or pending litigation has occurred?
- Does the franchisor have an advisory council with its system, how active is it and what decisions are they involved in?
- How many franchisees' have left the system or have not met their development commitments?
- What is the turnover rate of existing franchise locations?

- What has been the record for new franchisee recruitment?
- How is the concept performing in new markets?
- What has been the history of third party financing for the brand?
- What is the potential value of increased market penetration; what opportunities to achieve that will an acquisition represent?
- What is the strength of the existing management Team?
- How many franchisees are under old franchise agreements that do not address current issues facing the brand?
- What percentage of franchise agreements will expire in the next 3, 5, 10 year time horizon?
- How old/young is the franchise ownership base? Will resources be needed for re-training?
- What is the percentage of multi-unit vis a vis single unit franchisees?
- What is the perception of the franchise brand/model by current franchisees? Do they see a need for change?
- How is the concept viewed in the marketplace by its current/future customers?
- How is the concept viewed by customers versus the competition?

It would not be unusual for a potential buyer to actually have contact with your existing franchisees either prior to or as part of their due diligence process. That contact may focus on the brand, the support from the franchisor, future growth and franchise relations.

At the same time, there must be an effort to undertake a minimally invasive acquisition and integration process to insure the integrity of the system as well as to protect the franchisee's business interests.

These acquiring companies and/or individuals will frequently have access to industry information on the performance of the system, informal contacts with other franchisors and their franchisees that may have informal or antedotical information on the system itself!

A potential acquisition may also be impacted by the perceived value of the brand and concept by vendors, lessors, the consumer, etc. High turnover rates, lease terminations, vendor issues may negatively impact the value of the concept.

A franchise system with strong unit level economics, capable franchisor corporate management, solid growth performance and potential, a viable brand, etc. are all foundations for maximizing the value of a concept, not only for the franchisor but also the franchisee's assets. Many of these attributes are directly related to systems with strong franchise relations. Where a buyer identifies that franchise relations issues exist between the franchisor and its franchisees and as a result, the performance of the system is affected, it will typically modify the value it determines for the acquisition itself.

Additionally, a system with poor franchisee relations may increase the potential risk of legal and business issues subsequent to M & A activity and consequently require the buyer to adjust their valuation accordingly.

<u>What To Consider Before an M & A Event</u>

We believe that there are four (4) key areas that need to be addressed and managed before, during and after the M & A process. These include;

- Protecting the Brand itself; your current brand/brands, the acquired brand and the new combined brand/brands
- Effectively managing the M & A process as it impacts both your existing, new and potential franchisees
- The current ownership of the system; publicly traded, strategic buyer, etc.
- The support group that influence the operations of your system (i.e. lenders, lessors, vendors, media, etc.)

While the specifics of the actions that should be considered during an M & A event will vary based on the individual circumstances of the event, whether you are an acquirer or being acquired, a merger, etc., the *key issue is to plan in the initial stages of development of your* *system, that eventually there will be an M & A event*. It may be part of your growth strategy in acquiring another system, or a sale as described previously under M & A activity.

The following are a number of recommendations to be considered and potentially implemented in managing franchise relations in the M & A process;

Protecting the Brand

A “brand” is defined as “a promise” and successful brands are systems that consistently deliver that “promise.” Your franchisees (and in many systems, your corporate operations) are responsible for delivering that “promise.”

The Brand is considered to be your and your franchisee’s most valuable asset! Your system standards and operating procedures, training, operational support, marketing, etc. have been established to protect the integrity and value of that brand. The Brands perceived value in the marketplace will have a significant impact on its value. One of the cornerstones of the franchise business model is the ability to quickly develop and grow brand awareness and recognition thru the use of trademarks, trade dress, service marks, patents, copyrights, trade secrets, etc.

From the inception of a franchise system and on a consistent basis, there are key fundamentals in managing a franchise system that need to be addressed. At a minimum they include;

- Utilize legal, financial and business resources experienced in the franchise model in the establishment of your system and documents
- Insuring your trademarks are properly registered and protected
- Insure your system is in compliance with both state and federal regulations
- Maintain current and accurate documentation of all agreements related to your franchisees
- Accurate records of related leases and operating information for your system
- Accurate and current financial records and management
- That your franchise agreements specifically provide you as the franchisor the right to “sell” the system

- That the franchisor has the right to acquire and operate (under specific conditions) other systems
- That appropriate conditions are established for your franchisees in their leases and finance agreements to address a potential sale of the system
- That your operating systems, standards, training, marketing and operational support protect the Brand and assure delivery of the "brand promise."
- That you commit to the significance of franchise relations as integral to the long term success of your franchisees, system and Brand. This "commitment" can involve;
    1. A commitment, established by ownership and senior management, to the significance of franchise relations in your system
    2. Development and continual improvement of specific training and operations support programs targeted at enhancing your franchisees operations and profitability
    3. Specific methods to create open dialogue and input from the franchise systems including intranet sites, advisory boards, "managing by walking around" (which means getting out and actually visiting your franchisees!), mentoring peers, etc.

WHY FRANCHISE RELATIONS ARE CRITICALTO EFFECTIVELY MANAGING THE M & A PROCESS AS IT IMPACTS YOUR EXISTING, NEW AND POTENTIAL FRANCHISEES

Adapting to Change is Always Difficult

The effective management of an acquisition event in the franchising industry demands intense preparation and cautious execution in order to overcome the inevitable emotional shake-up which most certainly accompanies this kind of organizational growth. When word gets out there is an acquisition in the wind, there is a measurable impact on all parties involved, but most acutely on the attitudes, feelings and performance of the franchisees being acquired. Keep in mind that many of these same concerns may also impact your corporate staff and operations. These operations have a significant impact on the performance of the system and must be addressed as part of this process.

The fact is most of this change or shift in attitudes, although unavoidable, is almost always negative. Usually people in both companies, but particularly in the one being acquired, must go through a major adjustment process. They have to adapt to a variety of new organizational realities, not the least of which is the change in relationship between their former franchisor and their new one. All of these changes may be for the better or for the worse, but the bottom line is they must be carefully managed in order to achieve a positive outcome for all parties.

For these reasons, the acquiring company must (i)learn to understand their new franchisee's primary issues and concerns; (ii) understand the company culture that may be dramatically different; (iii) diagnose and deal with any "unconscious resistance" issues; (iv) must develop and execute a well-planned transition strategy and finally; (iv) work hard toward building long-term relationships with their new franchisee partners. Throughout all these activities the acquiring company's management team and franchise support staff must maintain an intense focus on highly effective communications in order to make the transaction succeed.

Using sound franchise relations principles (2-way communications, trust, transparency, mutual alignment of goals) we suggest five (5) basic steps for helping franchisees adapt when a system is being acquired; however, this cannot "be lip service." The franchisees and your third party resources will recognize the lack of commitment sooner rather than later.

1. Learn and Understand Primary Issues and Concerns

In general, franchisees often resist change simply because one of the conventional ideas behind purchasing a franchise is for the comfort of a stable, proven and well-defined business model. Changes they fear or changes that are not of their own making ordinarily will elicit a great deal of resistance. This is a key point, because most franchisees whose parent company is being acquired will have had no part in that decision. Not only did they have no say in the matter, they often were taken completely by surprise.

Franchisees are blindsided, emotionally jolted, by the news that their corporate parent is being reshaped and given a new authority structure. This is somewhat like a child being hit cold with the word a new parent is entering the family structure, and maybe an existing parent is leaving the scene altogether. Rather disconcerting news, obviously, and certain to arouse extreme anxiety along with a variety of other unpleasant feelings.

Like the child who has just been “sold out” by the parent in the surprise move, franchisees usually feel no personal ownership of the decision someone made to merge or sell the company. Thus, the franchisees commitment to support the idea may be very weak.

The heightened state of uncertainty that is instantly created pervades the entire network of franchisees, they get jumpy. They wonder when the other shoe will fall. And because they fear additional surprises – particularly some regarding their own business investment safety – they move instinctively to protect themselves.

Each of these issues; being taken by surprise, having new parents and having no control over certain decisions, all need to be managed in the context of the franchisee/franchisor relationship. Here are a few steps that can be taken in order to minimize these potentially negative feelings:

a. Engage the effected franchisees in the discussion of potential benefits from the acquisition (as confidentiality restrictions will allow);
b. Provide detailed information on the quality, structure, personality, and culture of the incoming parent company; and
c. If possible, involve the effected franchisees in the decision process – try to get their “buy-in”. An Advisory Council can provide significant assistance n this process. The franchisor knows why they are involved in an M & A event, their vision for the company and Brand, and if sound, this rationale and vision will resonate well with the franchisee leaders. They can be a very valuable resource in communicating this to the system.

2. Unconscious Resistance

As hard as the new parent franchisor might try to provide renewed levels of communication, participation and assurance, the acquisition and the potential changes it brings are still going to be resisted deliberately, as well as unconsciously. Some franchisees will be very outspoken and overt in expressing their dismay. Instead of trying to conceal their opposition, they purposefully vent it, perhaps in hopes of short-circuiting the deal. Sometimes, franchisees will choose to be very open in expressing their shock, anger, and frustration, and in many cases will not be able to hide their feelings even if they tried.

The unconscious resistance may be much more subtle, but no less damaging and often even more widespread. It is more passive in nature and is manifested most visibly in operating performance. These franchisees may even insist they are cooperative and support the newly formed organization, but the hard facts are arguably very different. The unconscious resistance will manifest itself in lowered morale, lower productivity, loss of competitive advantage, disappointing profits and most critical for the acquiring company, a deterioration in royalties.

Even when franchisees in the acquired organization make a concerted effort to adjust and embrace the merger, it can turn sour. Coping behaviors tend to be highly self-oriented and thus dysfunctional as far as the organizational good is concerned. The things people do and don't do in looking out for themselves are frequently incompatible with what the organization needs from them at that point in time. Much franchisee behavior that is well intentioned and even self-sacrificing runs counter to what should happen in a merger environment. For these reasons, there is a tremendous premium placed on the acquiring company's support team to quickly and effectively communicate and manage the franchisee's adaptation to their new business reality. You may want to consider starting those efforts with the leaders and top performers (which may not always be the same) since they typically have influence and respect from other franchisees.

3. Develop and Execute a Well Planned Strategy

A well planned and efficiently executed strategy for managing the acquired franchisee's emotions, expectations and operational needs is the key to success in a franchise environment acquisition event. Even with all the inherent complications of mixing human nature with the intensely stressful and difficult process of an acquisition, there are still tremendous benefits to be realized by all parties involved. These benefits are the most powerful tool in the transition process, so the communication of a clear and concise plan to deliver new services, enhanced support, additional assets and any other benefits resulting from the acquisition become most critical.

The first benefit to communicate should be at the heart of the entire acquisition process, that is the answer to the question; "why did these companies merge or why is one acquiring the other?" The answer to this question is found among the basic reasons companies typically buy or merge. Those reasons and a brief description are as follows:

1) <u>Faster growth</u> – accelerating the number of franchise units beyond what simple sales and development can accomplish.

2) <u>Vertical integration</u> – stability of supplies, controlled outlet for products, eliminate middle agent and developing economies-of-scale.

3) <u>Horizontal integration</u> – broadening the range of services that may be delivered to similar or existing customers across multiple concepts

4) <u>Acquisition of intangibles and personnel</u> – intangibles like technology, a marketing network, contracts or other resources – difficult to duplicate on your own. People who have knowledge, training and experience the acquirer needs.

5) <u>Changes in industries</u> – entry into a totally new industry with strong market potential.

6) <u>Portfolio investment</u> – diversifying the number and types of companies within an existing investor group portfolio.

7) <u>Marketability of Stock</u> – enhancing the market value of existing Stock.

8) <u>Potentially leverage marketing resources</u> across Brands.

Considering each of these possible reasons for entering into an acquisition, the first four seem to be most typical within the franchising community. It is critical for the acquiring company to articulate and to include in their communication strategy a dialog demonstrating that one or more of these objectives will deliver specific and tangible value to their newly acquired franchisee constituents on an individual level.

In general, acquisition strategies and procedures may vary from being an isolated event, to being a regular part of the business. In the franchising industry, most acquisitions seem to be more isolated events seeking to accomplish very specific market strategies or synergies. Because these events are not all that common, franchise support personnel are not always fully trained or experienced at the acquisition process. For this reason, particular attention must be given to the communication tactics used by support personnel during the transition process and they should be provided with the necessary training, orientation or tools necessary to get the job done.

4. Build Long Term Relationships

As support personnel begin to consider the communication challenges they must face, they are confronted by the fact the most important part of the acquisition occurs after it is concluded – answering the question, "does it work for both sides?" For this reason, the parties to the transaction should avoid thinking of the event in terms of coming to a close, but instead think of it as the beginning of a long-term relationship.

The various aspects of the acquisition agreement should be geared toward the on-going development of the long-term relationship. For example, employment agreements with support personnel should not be simply geared toward immediate negotiating positions, but instead should be designed to encourage and motivate the employee to participate and achieve higher levels of performance anticipated through the combination of both company's assets.

5. Focus on Effective Communications

As is common with all situations involving franchise relations, effective communication is the key element for success. Given the tumultuous nature of an acquisition event, effective communications are going to be at the heart of both the franchisee's and the franchisor's ability to adapt and make the necessary adjustments for a smooth and successful transition during the acquisition. The "take-away" from this examination of the acquisition process is, a) begin communicating with the franchisees involved as soon as confidentiality requirements will allow,

b) if possible, obtain their emotional "buy-in" of the benefits to be gained, c) quickly provide access to and facilitate implementation of new support services or products, and d) focus on building long-term relationships with all parties as the result of the acquisition. As an example, meeting with the Advisory Council will show the proper tone and the group's value. If an opportunity presents itself, meet with the entire system in person, and insure clear, concise communications to avoid and/or address any misinformation.

From the franchisee's perspective it will be critical to communicate how the combination of company assets creates greater value for their franchise investment over the long term. There may also be very immediate needs to address in the short term, such as offering new support services, marketing programs, collateral materials or other synergies not previously available to the franchisee from their former parent company or support team. The communication strategy must focus on quickly and efficiently getting this information into the franchisee's hands and simultaneously providing access to the new benefits.

Importantly, due to the very nature of the acquisition transaction, there may be certain communication issues that are further complicated by the positions of both parties involved. For example, on one hand, it is an adversarial situation in which both parties are attempting to negotiate and protect their own interests at every turn. On the other hand, there is an intense need for cooperation between both companies with an interest toward achieving a long-term outcome of mutual benefits. Because of the extensive due-diligence process, the length of time involved and the need for both parties to fully understand every element of each other's business, there is a tremendous premium placed on open, honest and clear communications.

Mix into this scenario the added complication of franchisee's being the primary constituents involved in the transaction (not typical employees) and you have just increased the need for highly effective communications by a quantum factor. Cooperation from both parties is required to achieve a smooth transition and successful initial operation of the acquired business. In the franchising industry can be a major challenge just to provide adequate support and establish cooperation with your existing franchisees; the challenge is amplified with an entire group of newly acquired ones.

Executing the Communications Plan

One of the most challenging issues is when and how to communicate that there is a potential sale or acquisition related to the franchise system. They can be complex and have potential impact, not only on the sales/acquisition, but long term operational success of the system and Brand.

Again, knowledgeable and experienced professional advice (i.e. legal, financial, public relations, etc.) related to the sale and acquisitions of franchised businesses are important resources, whether a buyer or seller.

- The “key issues” is to determine when a potential acquisition or sale can be disclosed and to whom. The ownership structure, agreements, etc. will all impact that decision. Generally speaking, an executed purchase agreement, subject to appropriate due diligence, may be that defined time.
- Who needs to know that an agreement is pending (franchisees, vendors, lessors, lending institutions, prospective franchisees, the press, consumers/customers, etc?).
- What is the message that will be communicated? What is the status of the transaction, estimated timeline, potential areas of impact, how will the transition be handled, how will this impact my business, etc.
- What is the message for your corporate staff? What is the message that will be communicated externally? What will the press, investor, etc. message look like.
- How does that message change with either lessors or vendors? If lenders are involved, how is that message established, including for your franchisees themselves to utilize.
- What about your marketing and public relations resources; how should they be involved in this process.
- What is the message to your customers? How will this transaction benefit them?

THE ROLE OF EFFECTIVE COMMUNICATIONS

One of the hallmarks of a successful franchise organization is effective two-way communications between the franchisor and franchisees. The concept is well-known but how do you achieve effective communications? Each franchisor needs to engage a strategy for what works best in communicating with its franchisees in order to maximize the use of resources and drive system-wide performance. It is essential however, that the communications is open and honest. It is critical to your communications plan. This is especially true on the part of the franchisor acquiring another franchise system. When developing this strategy several factors must be carefully considered and then incorporated into the fabric of an effective communications plan.

A simple given truth is that communications is the main ingredient in any successful franchisor/franchisee relationship particularly where there is a combining of two franchise systems. Therefore, it is vitally important to determine the effectiveness of the franchisor's communication with its franchisees. Some basic traits of effective communications are:

1. The franchisor defines and clarifies its ideas prior to communication with the franchisee.
2. The franchisor analyzes a franchisee's situation prior to recommending actions.
3. The franchisor says what needs to be said clearly, concisely, and quickly.
4. The franchisor listens to the franchisees, including listening to a franchisee's questions and then preparing answers that will help facilitate understanding.
5. The franchisor seeks feedback from the franchisees in a variety of ways and provides a means for franchisees to respond.
6. The franchisor does not make negative statements, such as "We have tried that before and it didn't work", or "It costs too much", or "We don't have time to consider your idea", etc. Such statements will stifle the communications between parties. Instead, the franchisor should indicate they will consider the ideas and investigate further.
7. The franchisor openly and continually expresses to franchisees the importance of active communications and the role they play in everyone's success.

8. The franchisor recognizes and promotes franchisees who submit good ideas and are active in the process of two-way communications.
9. The franchisor pro-actively contacts struggling or unhappy franchisees and seeks out their input on a variety of issue

The above traits are common among most successful franchisors and tend to be recognized as requirements for achieving effective communications in franchise relationships.

Strategy Begins With Methods

The successful franchisor will use a variety of methods to communicate. Different types of communications include phone calls, personal visits by field support representatives, web-based intra-net systems, electronic bulletins, newsletters, email and other forms of electronic media. Franchise Advisory Councils are also considered a communication method which allows the franchisor to facilitate face-to-face meetings with key franchisees in order to collaborate on key initiatives, policies and/or important marketing directives.

Given a franchisor is either developing or actively using several, if not all of the communications methods above, the next challenge is to create the environment in which all these methods will be effective. *The attitude or culture with which the franchisor views the franchise relationship now becomes the key driver for effective communications.*

A franchisor with the attitude of a business "partnership" with the franchisee is going to achieve the best results. With this type of attitude, both the franchisor and the franchisee will continuously work together to develop new ways to benefit from the relationship. Both parties will look for ways to help each other improve the operation of the franchise system. This results in a win-win situation since both sides will look out for each other and their best interests.

Positive Culture Creates The Right Climate

When trying to build a positive culture within a franchising organization combining two or more systems at least four (4) common characteristics emerge as essential building blocks for a successful franchise relationship. Those characteristics are strong listening skills or "active listening", a two-way process for all communications, trust in the relationship and a mutual alignment of goals. Again, all these attributes depend heavily on an ever-present communications platform by which all parties can exchange ideas, discuss issues, devise resolutions and plan for success.

It is important to emphasize again that whether in the normal course of business or in a post-sale assimilation and cohesion, a strong advisory council can be a valuable resource, asset and partner in successfully executing and accomplishing effective communications.

Use Active Listening Skills

The most common way to discover someone is **NOT** listening to you is when they cut you off in mid-sentence or before you can complete your thought. How can they be listening to what you are saying when they don't even hear the end of your sentence? Can they read your mind? Not likely, unless they are a new arrival to our planet. A good listener will carefully focus on the other person's complete thought before responding or forming an opinion of their own.

It is sometimes referred to as "active" listening skills, and it truly takes energy and patience to do it well. Here are a few tips for improving your listening skills:

- Focus eyes and mind on the person speaking.
- Indicate listening through eye contact, note-taking and body language.
- Respond appropriately with comments, questions or paraphrasing.
- Use questioning to clarify specific points of discussion.
- Repeat words or phrases in your own words to verify understanding.
- Summarize a discussion to confirm main points and a complete, accurate understanding.

Two-Way Process

The previous reference to Advisory Councils is a clear example of how the two-way process of communication is being deployed in the franchising industry. Here, franchisees are being invited to the proverbial table by the franchisor for the expressed purpose of speaking their mind and exchanging opinions. Although most Advisory Councils do not have a final vote on policy decisions, a wise franchisor will consider advisory input in the setting of priorities and in the allocation of resources. Both parties must feel free to communicate openly and honestly, and in doing so, they are clearly on a two-way path toward stronger relations.

Field Support is another franchising function which relies heavily on the two-way process, and the communication is not always simply verbal. Greg Nathan writes in his book titled The Franchisor's Guider to Improving Field Visits, "…research into franchisee satisfaction by the Franchise Relations Institute has shown that franchisees who believe their franchisor genuinely cares about them are significantly more likely to trust the franchisor.", and, "Face to face contact demonstrates that you do care and helps to build positive communications and trust."

With that being said, a Field Support Representative is charged with guiding and supporting the franchisee through the various stages of their business development from grand opening to final sale. As part of this relationship, the representative will play a variety of roles including consultant, mentor, facilitator and trainer, all of which require a two-way exchange of thoughts and ideas. Each of these roles may require a different type of relationship, such as one commanding leadership, another communicating as a peer or possibly educating as an instructor. But, all of these roles rely heavily on the effective use of communication skills, and more importantly are dependent on a strong level of trust. And actions speak much louder than words!

Company Culture Sets the Tone

Company culture is loosely defined as "the pervasive or common attitude among the employees and managers," and it usually emanates directly from the top down — mainly from the CEO and other executive officers or managers. Whether in franchising or in the corporate world, it is this same attitude or culture which sets the tone for company policy, communications, personnel decisions, resource allocations, marketing campaigns, public relations, and, most importantly for this handbook, the foundation for effective franchise relations. It is imperative that respect for the franchisees be a top priority as part of the company's culture.

In a collaborative or supportive company culture, franchise relations are built on a foundation of strong franchisee support which, in turn is fueled by the strength and breadth of the company's resources. When every member of the franchisor organization believes in this mission of support, then beginning with your mission statement which will set the basis for your interactions, every contact, every phone call, every piece of marketing material, and every activity at the Home Office becomes part of the support function. Without this commitment of purpose toward franchisee success and profitability, it is difficult to actually develop or maintain effective franchise relations.

The "You Win, We Win" Culture

This supportive organization culture in the franchising industry is often described by the phrase "if the franchisee succeeds, we succeed." This principle allows for strong two-way communications between franchisor and franchisee; it allows for a mutual alignment of goals (you win, we win); and it is a solid foundation of which a trusting relationship can be built. These common characteristics of strong franchise relations are the foundations on which effective franchise relations are built.

On the opposite side of the spectrum, a franchise organization which primarily believes only in the franchisor's key objectives; one in which communications are closed and secretive; and where ulterior motives lurk behind vendor relations, territory alignment, and strict adherence to one-sided policies, effective franchise relations can be hampered by any number of trust and relationship issues. In this type of dictatorial culture, the franchisee is much more likely to be suspicious of franchisor-lead initiatives and even less likely to participate in potentially beneficial changes. At the very least, even today, a vast amount of resources, both materials and personnel, get wasted in this type of dysfunctional relations environment.

While the company culture indeed sets the tone for the effectiveness of franchise relations, there are several other fundamental principles which also play a major role in the ultimate success or failure of a franchise organization. The principles for maintaining strong franchise relations include strong two-way communications, building an atmosphere of trust, aligning the organizational goals for everyone's mutual benefit and maintaining a transparency in the allocation of company resources.

Franchise Relations are the Foundation

Conventional wisdom within the franchising industry suggests the most successful organizations are those which focus their time, resources, and talent toward franchisee support functions. Experience has proven there is a strong correlation between the quality and depth of the franchise organization's support functions and the ultimate success of their respective franchisees. So, how do you effectively deliver or achieve adoption of these support functions within a group of unique and self-motivated franchisee operators? The broad stroke answer is through sound franchise relations. And the franchisors whom adopt these philosophies and practices actually "win" when the franchisees come first and they understand and trust the franchisor's management and vision.

Strong Relations Allow Constructive Development

The term "constructive development" in the context of franchising implies a certain level of high quality, bi-directional communications between franchisor and franchisees. All parties must rely on an open, honest relationship for setting goals and completing their respective functions. If they can't work together in a mutually beneficial environment, then nothing is going to get accomplished. If they can work together constructively, then positive end results are possible.

The other characteristics associated with developing sound franchise relations include a strong foundation of trust, a solid alignment of goals, and transparency in the allocation of resources. It also includes an expectation that the franchisees do their part as well in building strong relationships.

Trust Is Essential

Trust is the bond that allows two parties to openly communicate their ideas and feedback, good or bad, and eventually collaborate on a path of mutual benefit and motivation. If there is an absence of trust and the relationship is perceived to be one-sided or deceptive, then it will most certainly fail. For example, a franchisee suspects the franchisor introduced a new product primarily for their own gain by way of a back-room deal with a supplier; the result is no adoption — no trust. Make the same product available as the result of identifying mutual benefits for all and collaboration between parties, and adoption is nearly certain — trust is strong.

If the franchisor has developed its business model/revenue model around the collection of royalty fees as its **PRIMARY** source of financial success, then there is a resulting necessity to reinvest a significant portion of those funds in a support and development infrastructure. These investments are clearly visible to the franchisees and they play a vital role in building a trusting relationship, not only with field representatives, but with the franchisor in general.

Alignment of Goals Equals Mutual Benefits

One of the most common attributes in successful organizations to ensure a solid foundation of trust is a strong alignment between the franchisor's goals and objectives and those of the franchisee. For example, when the franchisor operates from a philosophy of "if the franchisee wins, we win," there is typically a strong alignment of goals. If the franchisor chooses to build a singular-minded culture around "profitability at all costs," there is likely to be a disconnect between alternative revenue streams and a genuine concern for individual franchisee success, and any financial gains are typically short lived, with significant long term implications. Inherent in the "you win/we win" philosophy is everyone participates at some level to achieve mutual benefits. If the franchisee is financially successful at the local store level, then the franchisor by definition is going to benefit from increasing royalty revenues. The franchisor is also participating by allocating, dispatching, and managing an effective team of field representatives who provide a wide variety of support services, collateral materials and new franchisee development.

It is the responsibility of the franchisee to execute the franchisor's business model, and it is truly their hard work and motivation that achieves sales growth, market share, and financial success at the end of the day. However, the alignment of both parties' goals is what allows and stimulates on-going investment in the franchise concept.

<u>Transparency and the Allocation of Resources</u>

In today's environment of instant communications, phone and email contact anytime and anywhere, the fact is, everyone knows how much is being invested and by whom. So, to achieve a mutually beneficial return-on-investment, there needs to be visibility into what each party is contributing, and, in today's vocabulary, that is referred to as "total transparency."

In a strong trust relationship, total transparency and the allocation of resources go hand-in-hand. Because the franchisor operates from a position of only doing those things intended to benefit the franchisee, there should be no fear of disclosure, good or bad. Through combined trust and visibility, a field representative can openly engage in all facets of the support organization to deliver the right resources to the right franchisee at the right time.

Unfortunately, no franchisor can afford unlimited support resources and must therefore work to maintain a delicate balance between the effective distribution of limited support resources and the priority of serving franchisees with the greatest needs. Often, both the franchisor and franchisee are dependent on the field representative to meet the challenge of determining the tipping point between positive results and diminishing returns.

The problem is complex. It is easy to focus attention on top-producing franchisees given their proven track record for success. Over-allocation of resources to under-performing franchisees may produce little in positive results. Franchisees facing specific business and market challenges need more than phone support and "generalist" consultation to survive, but the franchisor cannot afford unlimited field services nor deliver a support specialist to the doorstep of every franchisee in need. Additionally, the business needs of a multi unit franchisee are typically different from those of a single unit operator. So, what is the answer?

The answer can lie with the support representative who can make critical and sometimes unpopular resource allocation decisions. Top performers, under performers, and every franchisee in between want their fair share of these limited, yet vital resources. The support representative must rely on the strength of established franchisee relationships to effectively deliver “needs-based” consulting time, “geography-driven” generalist materials, and support when they are needed and where they will accomplish the most good.

POTENTIAL STRATEGIC AND OPERATIONAL ISSUES

Each M & A transaction will present varying, potential unique issues.

As an example, when an appropriate time has been identified to announce a transaction, a meeting with your internal staff might be appropriate to establish initial communications. What is the message that you want them to communicate to franchisees, vendors, etc.; or who should communicate it? Keep in mind that your internal staff will have a number of concerns as well about a transaction and frankly, you will be relying on them for a significant and frequent amount of communications with your franchisees. You want them to be well informed and to the extent possible comfortable with the future value of the event not only to them but the entire Brand and system.

Subsequently, a meeting with the franchise advisory board might be an appropriate and important next step (one that should occur as soon as possible; potentially before disclosure to your franchisee system, etc!). A key focus should be on the potential value of the transaction to the individual franchisees and system itself, timing, etc. Have you given thought to potential expenses that might be incurred by your franchisees in an M & A event, business interruptions, supplier issues, etc? How will they be addressed?

Current development activities by both existing and new franchisees may be impacted by an M & A event. Since this typically represents a “material change” within your disclosure documents, it is important to have a strategy in place to provide revised disclosures to these individuals as well as manage the potential impact of delayed development. The value of a transaction will generally, provide the same benefits to a new franchisee. An important part of developing strong franchise relations is to be prepared to work with your new and existing franchisees in addressing these circumstances.

Managing the relationship with your franchisees and the system itself, particularly during difficult and stressful circumstances, requires ongoing, consistent communications from every resource (within the parameters established by the transaction itself). Do not under estimate the importance of insuring the consistency of the message and information being communicated. Don't over promise, be actuate and honest in the information that is presented. Insure a continuum of communications as the transaction itself proceeds.

When feasible, making every effort to have the new ownership meet with corporate staff, franchisees, vendors, lessors, etc. (where applicable) can be an effective way to begin to build confidence with these groups. Insure that everyone is prepared for these meetings; have a consistent message focused on the value of the transaction and its long term benefits, etc. This activity does not end with this initial contact, but as a long term strategy in building your franchise relations, there must be an ongoing commitment to these efforts. Being honest and straightforward since trust can dissipate quickly in an adverse environment. Be prepared to not allow a "vocal minority" from controlling or "hijacking" the message.

A strategy related to all of these parties that may be impacted by potential activities related to an M & A transaction needs to be identified and addressed. The fact is however, you may not have all of these questions addressed at the time the transaction is announced (i.e. potential closures due to market impact, lease terminations, vendor issues, etc.) since each will have its own unique set of circumstances. However, being prepared to discuss how you will approach determining how you these issues be addressed is important in the communications process.

- will the transaction impact your relationship with current vendors,
- how will locations that are currently operating in existing markets be addressed,
- will the acquired units continue to operate as a separate system
- if existing units are required to make brand related changes, how will they be addressed and "paid for?"
- what happens to existing corporate units in similar circumstances
- what's the timetable, etc.

It is important to have a consistent plan for continuing follow up and updates both for your franchisees and corporate staff.

Meeting with other companies that have gone through a similar event, potentially the acquirers past experience, some common sense, etc. are important resources in establishing and executing your individual strategy.

CONCLUSION

William Rosenberg, the founder of Dunkin Donuts and the International Franchise Association so eloquently described the essence of franchising when he said "there are no successful franchisors without successful franchisees and there are no successful franchisees without a successful franchisor."

Solid franchise relations are a key element to a strong and viable franchise system particularly when combining two franchise systems. These relationships can have a material impact on the value of a franchise system and its future. Building those relationships is the result of a strategic and consistent effort orchestrated by ownership and senior management. Those efforts need to start with your first franchisee!

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