WHAT ARE INTERNATIONAL LICENSEE CANDIDATES LOOKING FOR FROM FRANCHISORS?

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AGENDA

• 1. Larry - Brief Introduction to International Expansion
• 2. John – A Canadian Master franchisee’s Perspective
• 3. Alejandro – A Mexican Area Developer’s Perspective
• 4. All – Q&A roundtable discussion
International Franchise Expansion Methods

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METHODS OF EXPANSION

• What method of franchising should you use outside of your home market.
• A summary of the "pros" and "cons"
THE MOST COMMON METHODS OF EXPANDING BEYOND YOUR HOME TERRITORY

1. Direct (Single Unit) Franchising;
2. Master Franchising;
3. Area Developers;
4. Joint Venture franchising;
5. Area Representative; or
6. Hybrid of some of the above.
DIRECT FRANCHISING

• The franchisor acts as franchisor to the single unit franchisees in the foreign market.
• Often used when growing within your home country, but less frequent now when going international.
• Still common from U.S. to Canada
DIRECT FRANCHISING (CONTINUED)

- **Pro:** Owner/Operator franchisees; Highest level of control by franchisor.
- **Cons:** Harder to manage the less sophisticated type of franchisee from a distance.
- **Need to replicate the franchisor’s business in the new market (branch office, tax and liability issues).**
 MASTER FRANCHISING

- The franchisor grants to a local “master franchisee” the right to sub franchise in the foreign market.
- A commonly used way to grow outside of your home territory, especially to another country.
- Attractive because master franchisee can become self-sufficient, as a franchisor.
• Pro: Typically only sophisticated candidates need apply
• Self-sufficient master who takes over many of the franchisor's functions.
• Con: Problems in finding the right Master Franchisee when so much riding on one person or group
• Another layer, but only one pool of revenue... Can everyone make money?
The franchisor grants to a local “area developer” the right to become a single unit franchisee multiple times, in a defined (often exclusive) geographic area.

Becoming more common as franchisors are looking for more sophisticated franchisees who can be self-sufficient.
• Pro: Typically only sophisticated persons or companies need apply
• Striving for self sufficiency as a area developer can take over many of the franchisor’s functions.
• Con: Problems in finding the right Area Developer when so much riding on one person or group.
• Can they operate units and fulfill other functions of franchisor?
• On a small scale, just like single unit franchising
JOINT VENTURE FRANCHISING

• The franchisor grants to a local entity certain rights (i.e.: single unit franchise, master franchise, or area development rights).
• Franchisor itself owns some part of the entity together with a local “partner”.
• An alternative to the franchisor opening up a new market on a purely corporate or franchised basis...seen as a middle ground.
Pros: Sometimes the best of both worlds.

Cons: Often franchisor is too far away to keep proper tabs on what is going on, and so to do it right, needs to establish a corporate like presence in the market.
• The franchisor grants to a local entity certain rights to market, offer and perhaps even train and service franchisees on behalf of the franchisor in a new market.

• Actually an agency or broker arrangement.
• Pro: Fewer ties to new market. Sometimes this route can avoid franchise laws.

• Con: Franchisor often ends up dealing with unit franchisees, and is in no better a position than if franchising directly.
HYBRID OF THE ABOVE

• Many deals are done with some elements of all of the above.
• For instance, many master franchise deals require that the local master franchisee operate a minimum number of corporate stores.
HYBRID OF THE ABOVE (CONTINUED)

• **Pros:** Can tailor the arrangement to the situation, and end up with most suitable arrangement of master franchisee and area developer.

• **Con:** Too much time and money spent customizing the deal.
HOW TO CHOOSE?

• The domestic method of franchising may not work outside of the home market or internationally.

• There can be significant differences country to country or even within countries.
“Progressive Development”- in a new territory, start small, especially if franchisee is new and unproven, and let them earn the right to grow beyond their initial territory.
• “Manage the Growth” - growth outside of home market must be financially accretive

• Financial modeling to determine what the growth adds to the franchisor.
• “Self-Sufficiency” - more franchisors are looking to establish their brand in a new market through master franchisees and/or area developers who can be self-sufficient.
• Moving away from single unit franchise sales.
• “Can Everyone Make Money?” - perhaps this should be obvious.
• Long established support system in domestic market vs. building that today from scratch in a new market.
WHAT DO THE BUSINESS PEOPLE SAY?
(Continued)

• Look to MF/AD to take over training, marketing, purchasing, support, real estate, etc. in the new market - can your candidate do all or some of that?
• John Prittie, MBA - President, Heron Capital Corporation
HCC is a Franchise Management Company

- Master Franchisee for TWO MEN AND A TRUCK® in Canada
  - Largest US franchise mover specializing in home & business moving
- Franchisor for PROSHRED® Security
  - pioneered the mobile paper shredding & recycling industry
• Currently looking for new Master Franchise and/or Franchisor Opportunities
• Two under consideration at this time
Involved in franchising for 30+ years
Awarded 600+ franchises globally
  – Single unit franchises
  – Master Franchises
  – Area Developers
  – License Agreements
Previously affiliated with the following franchise systems:
- Mini-Tankers® - Onsite diesel refueling
- Shred-it® - Mobile paper shredding & recycling
- Mr. Lube® - Quick lube/oil change
- Jumbo Video® - Video rental
– The Country’s Best Yogurt (“TCBY”) - soft serve frozen yogurt
– Prime Restaurants - Full service restaurant chains
  • East Side Mario’s
  • Casey’s
  • Pat & Mario’s
  • Lime Ricky’s
– Mother’s® Restaurants - Full service and take out & delivery restaurants
– Mr. Grocer® - Supermarkets
– Mini-A-Mart® - Convenience Stores
• The Country’s Best Yogurt® - USA concept introduced to Canada
• Mini-Tankers® - AU concept introduced to Canada & USA
• TWO MEN AND A TRUCK® - USA concept introduced to Canada
WHY BUY A MASTER FRANCHISE?

• “Imagine coming up with the idea of a new franchise concept that explodes in your area with dozens of new units opening up”.

• “Imagine having control of this concept and receiving royalties and franchise fees on a consistent basis”.
Why Buy a Master Franchise?

(Continued)

• “Imagine having an idea like McDonald's® and having people line up at your door to buy into your opportunity”.

• “Imagine having access to the best business experts to help guide you in your new venture”.

• “This opportunity is extremely rare, yet there are such businesses available if you know where to look”.

• “This unusual and highly successful opportunity is called Master franchising.”

• Source: www.azfranchises.com/whymasterfranchise.htm
• Knowing where to look to find these “rare” opportunities is an important 1st step
• Knowing what to look for to find these “highly successful opportunities” is a more important 2nd step
• Knowing how to evaluate a “Master Franchise” is the most important 3rd step
OUR APPROACH

• Starts with an extensive and thorough review … many questions to be asked and answered!
  – Concept
  – Franchisor
  – Operations
  – Information Technology
  – Software
  – Sales
  – Marketing
  – Financial
  – Legal
CONCEPT

• How will the concept work in the target country?
  – Understand the concept and what makes the business system, product or service unique, different, desirable, successful
  – Complete extensive market research to determine if the business system, product or service will have a similar or different application in target market
Circumstances exist that will impact the application and successful introduction of the business system, product or service:

- i.e. competition, climate, population density, geography, disposable income, different tastes, cultures, norms, habits, traditions, religion, government regulation e.g. taxes or tariffs, business practices, etc.

To what extent will these circumstances impact the successful introduction of the business system, product or service in target market?
• Do your homework on the Franchisor.
  – How long have they been in business?
  – How many Franchisees do they have?
  – Is the Franchisor’s domestic franchise program a success and do their Franchisees validate?
  – Is the Franchisor “solid” financially?
– Why is the Franchisor looking to expand internationally?
– What actions has the Franchisor taken in preparation for awarding a Master Franchise in the target country?
– Do they have any other Master Franchisees?
– Is the Franchisor’s Master Franchise program a success?
– What is the Franchisor’s senior management team commitment to Master Franchising?
– What is the breadth and depth of the Franchisor’s management team, knowledge base, tenure, etc.?
– Does the Franchisor have personnel dedicated to supporting Master Franchisees?
– Is the Franchisor a good communicator?
– Is the Franchisor a member and active in the IFA or other franchise associations?
– Is the Franchisor a member and active in industry associations?
– Has the Franchisor done any market research?
– Has the Franchisor ever been to the target country?
• Operations is all about uniformity and consistency.
  – Are the Franchisor’s operations manuals professionally developed, current and well documented?
  – Are the Franchisor’s training programs professionally developed, current and well documented?
– Are these manuals available electronically?
– Will you be required to operate one or more “corporate units”?
  • If not how will you learn the system?
– Will you be permitted or obligated to attend annual meetings and/or ongoing training programs with the Franchisor’s domestic franchisees?
  • If not, how will you stay current with best practices?
- What manuals has the Franchisor developed to assist you in recruiting / awarding franchises?
- Are there critical supply chain elements and are they available in the target country?
- How many days/weeks of ongoing support will be provided and at what cost?
INFORMATION TECHNOLOGY

• The tyranny of distance and time zones can be somewhat offset by technology.
  – Does the Franchisor have a well developed IT infrastructure?
  – Does the Franchisor utilize proprietary or customized software, etc?
– Can the Franchisor’s proprietary or customized software, etc. be used and supported in the target country?
– What costs are involved to purchase licenses, modify software, etc.?
– How will future software upgrades or technology changes be handled?
- Does the Franchisor have professionally developed and well documented proprietary or customized software manuals?
- Does the Franchisor have a professional and well developed web site/intranet/extranet and email platform?
- Will you be required to develop your own web site, email platforms, etc?
• Master Franchisees will be responsible for selling more than the business system or the products or services.
  – Does the Franchisor have professional, current and well developed sales and marketing tools to help you sell and market the business system, products or services?
– Does the Franchisor’s “Brand” have any awareness or recognition in the target country?
– Will the Master Franchisee benefit from any national or international sales and marketing campaigns, programs?
SALES & MARKETING (CONTINUED)

– Does the Franchisor have professional, current and well developed sales and marketing tools to help you recruit and award franchises?

– Does the Franchisor sponsor any internet sales activity or lead generation for either the business system/products/services or franchises?
• There are many financial matters to review.
  – Does the concept generate strong sales and/or margins and is it reasonable to assume these can be replicated in the target market?
– What is the Master Franchise fee structure?
  • License fee or management fee? Training fees? Royalties? Ad fund? etc.
  • Do they adequately reflect the division of responsibility?

– What are the payment terms for fees?

– What about currency exchange and withholding taxes?
– What is the market potential for the target market given development plans?
– Given the length of the Master Franchise Agreement and the development schedule is there an appropriate “ROI”?
– What implications does exchange have on the economics for the Master Franchisee or individual Franchisee?
• Are there any duties or tariffs on inventory, supplies or equipment that is mandated by the Franchisor?
• Who is responsible for the cost of translation of marketing and training materials and operations manuals?
What infrastructure needs to be established and at what cost to open and operate one or more “corporate” units?

What infrastructure needs to be established and at what cost to recruit, award and support franchises?
What differences exist in the target market with regard to income statement and cash flow items for either the individual Franchisee or Master Franchisee?
• What capitalization is required for the individual Franchisee and how would that compare to the Franchisor’s home market?
• What capitalization is required for the Franchisor?
• Will there be issues with financing or leasing?
There are many legal aspects to be considered.

- What is the status of the Franchisor’s trade marks and can they be protected and translated appropriately?
- Is the Franchisor prepared to modify trade marks, slogans, due to translation or pirating problems?
– Are there any industry specific laws in the target country that could impact on the business in any way?
  • Franchise legislation, import/export, transportation, etc.
– Will real estate be an issue?
– What is the term of the Master Franchise Agreement and what options are there to renew?
– Are the terms and conditions contained in the Master Franchise Agreement fair and reasonable and not too restrictive?
– Is the development schedule reasonable?
– Choice of law?
– Choice of language?
– Does the Franchisor require personal guarantees of the Master Franchisee?
• Lesson learned .... The Master Franchise Agreement was far too restrictive!
Issues arose with store design, real estate selection, the purchase of furniture, fixtures and supplies, exchange rates, tariffs & duties, product line, development schedules, fees, royalties, etc.

The Master Franchise Agreement did not adequately provide for local market adaptation which ultimately lead to the failure of TCBY in Canada.
Lesson learned .... Insufficient market research was completed prior to the introduction of Mini-Tanker’s service to North America
- Climate, customers, products, services, equipment, technology, supply, distribution, etc. were all so very different.
- It took many years of adaptation, trial & error, recapitalization, re-branding, etc. to bring a viable business model to market.
• Lesson learned .... you can find a highly successful franchise opportunity in Master Franchising provided you:
– take the time to get to know the Franchisor and understand the concept, its operations and how it’s marketed, sold and serviced

– you are successful in negotiating legal and financial arrangements that are fair and reasonable to both parties
• I personally would not characterize Master Franchising as either “an unusual” or “a highly successful business opportunity”
Master Franchising is very commonplace

Needs to be an appropriate sharing of revenues between Franchisor & Master Franchisee

Master Franchising is not a “get rich quick” scheme

Make sure you enter the world of Master Franchising with your “EYES WIDE OPEN”
• The Perspective of a Mexican Area Developer for a US Franchisee.

• Alejandro Portilla Garceran.

• University of Southern California MBA, Dean list.

• Chairman of the Board Impulse de Capitales (Investment Banking).

• Chairman of Grupo Tovisa (Restaurants).
• Chairman of Promotora de vivienda San Vicente (Low end Housing, Construction).

• Chairman of Grupo Ambientes SA de CV (High end housing and commercial power centers developer).

• Chairman of Cancun Clipper Club (Time share and tourism company).
• Population of 112,336,000 people.
- Basic Wage 5.13 usd.
- Our PIB (GDP) is $1.135 trillion with a 3.3% growth (2012),
MEXICAN MACRO INFO (CONTINUED)

• Unit Labor Cost Mexico Vs China

Chart 19: Unit Labor Cost: Mexico vs. China

USD per hour

2.5
2
1.5
1
0.5
0


Source: BofA Merrill Lynch Global Research, MoF, Banxico, INEGI, International Labor Organization, China NBS
• 3.57% Inflation rate.
• Mexican treasure bills 4.12%, Mexican Treasure Bonds 5.47% (2012).
• Exchange rate 12.64 pesos/ 1 dollar (14 January).
• Government: Democratic model.
• Franchise market in Mexico generates 6.7 billion dlls in sales a year.
• There are 1013 active franchise formats in Mexico.
• It employs 500,000 people.

Source: Asociación Mexicana de Franquicias, http://franquiciasdemexico.org/
KEY STRENGTHS TO LOOK FOR IN A FRANCHISOR

- Global Brand awareness.
- Competitive advantage.
- High returns on investment.
- Strong support in operations.
- Fluent communication between Franchisee and Franchisor.
- Franchisee / Franchisor goals/interest alignment.
- Financial capabilities
• Ratio of Annual sales vs. Investment: 3 to 1.
• Documentation: Manuals, Audits, Training programs, Opening supports.
• Brand building support (advertising, promotions, etc.).
STEPS TO DEVELOP A FRANCHISE IN MEXICO.

• Create the appropriate board of directors for the Mexican entity.
• Develop a short/medium term business plan. Define your initial investment.
• Define model of development (Private placement, joint venture).
• Develop a strong operating team, that will assure to meet with the quality standards of the franchisor.
Initial operation should be 100% financed by equity.

After 3 years of successful operations, you can start thinking about leverage.

Joint venture is highly desirable, it implies strong accountability.

Competitive royalties, that allows good IRR for franchise.
• Create a Mexican corporation under Mexican law. There are many law firms with international experience.
• Laws that protect intellectual properties (brands), internationally.
• New law that increases flexibility with labor forces contracts.
• Taxes, 30% income, 16% value added tax
CONCLUSIONS

• The most desirable qualities in a franchisor:
  - Products or service, that have a well define competitive advantage.
  - Has a business approach to the venture.
  - Shares relevant experience and data for a successful launch of the initial project.
  - Willing to start small and growth from there.
  - Perhaps to co-invest (temporary with the franchisee).
- Low international executive rotation.
- High standards in the training program.

- **Mexico is a very stable country, social, economic aspects.**
- **Has a very young population, that has a lot of needs to be satisfied by local and international products.**
- **Mexican market offer wide opportunities for international franchisors**
UNDER GOING ACTIVITIES

- Four franchise under study
- Looking for new opportunities.
Thank you!

Q & A Roundtable Discussion