#IFA2016

Convention

FEBRUARY 20-23, 2016 // SAN ANTONIO, TX
International Summit – Track One
Session One: Finding a Partner, Due Diligence and Expansion Models

- Finding international franchisees.
- The role and importance of due diligence in international franchising.
- International development models.

- **Moderator:** William Edwards, CFE, Chief Executive Officer, Edwards Global Services
- **Speakers:** Tom Jaeb, President, Heartland Investigative Group
Recent IFA Franchisor Survey

79% operate internationally
72% believe international growth is very important to future success
84% plan to start or accelerate international operations
25% generate between 25-50% of revenue internationally
83% would like to participate in international trade missions & shows
Why Take Your Business Global?

• As Globalization has taken hold over the last 20 years, international growth has become a “must” for any company seeking high rates of sustained future growth.

• The economic challenges in western markets have accelerated the push into emerging economies.

• Branding has become more commonplace everywhere, representing a tremendous opportunity for a business concept to expand its footprint.

• However, as anyone who has tried to expand their brand internationally will attest, it is much easier said than done.

Catherine Monson, CEO, FastSigns®
Why US Franchises Are Attractive To Buyers In Other Countries

✓ Brands
✓ Quality
✓ Convenience
✓ Customer Service

US franchises have a systematic and reproducible approach to doing business that is world class and can produce good margins.
Green countries rank ‘1’ - projected highest GDP growth in 2016
Yellow countries rank ‘2’, good GDP growth in 2016
Light red countries rank ‘3’, moderate to low growth, little new investment
Light blue countries rank ‘4’ - very low or no GDP growth
Tan countries are not seeing substantial franchise investment at present

Countries in green and yellow are considered the best for finding new licensees in 2016
What To Seek In An International Licensee

A passion for and understanding of your business
A successful business with knowledge in your sector
Good reputation in the country
Experienced management to put into the business
Access to suitable real estate
Marketing oriented company
Capital to start and grow your business in their country
Sources Of International Licensees

1) Use your website – add an international landing page to your franchise section
2) Subscribe to international lead sites, such as franchise.org and franchisedirect.com, franchising.com
3) Use international brokers and consultants with global reach
4) Attend international trade shows
5) Network at the IFA
6) Use the U.S. Commercial Service (USCS) in target countries
7) Go on IFA/USCS Franchise Trade Missions
International Development Models
Typical Development Models

• Wholly owned subsidiary or Joint Venture
• Direct Area Development - via Multi-unit agreements
• Direct Single Unit Development
• Master Franchise / Sub-franchise Model

Greater control typically requires greater investment by Franchisor.
International Expansion Options Though Licensing

- Master Franchising
- Area License
- Joint Venture
- Direct Franchise
- Direct Investment

Adapted from Kurt Ullman

Direct Investment is associated with less control and less investment.

F&B franchises

The McDonald’s model

Sign-A-Rama in Australia

More control and more investment are associated with Direct Investment.

Adapted from Kurt Ullman
Wholly Owned Subsidiary and JV

• Typically only for highly developed and well capitalized franchisors and brands
• Joint venture leverages local market experience, capital and HR in exchange for some level of ROI and control
• Entity established to implement / replicate franchisor’s system in the new market(s)
• Examples: McDonalds and Starbucks
Wholly Owned Subsidiary and JV

Advantages
• High levels of control of management, development, brand and operations
• Potential for higher income levels

Challenges
• High financial investment and working capital requirements
• Significant and direct management and HR requirements
Area Development (Multi-Unit)

• Typically applicable to systems with:
  – Higher model complexity
  – Higher unit establishment costs
  – Well developed international support programs and HR

• Common for restaurant brands
Area Development (Multi-Unit)

- Typical parameters and financial model - very similar to domestic practices
  - Rights and obligations to develop a specified number of units during a defined timeline
  - Initial fees and royalty fee - same as domestic market
  - Payment of initial fees often 50% at signing and 50% at opening of a unit
  - Typically exclusive on a country, region or city basis
Area Development

Advantages

- High leverage of each franchise relationship due to multi units
- Same or highly similar to domestic development model
- Typically working with highly capitalized and well established franchisee entity

Challenges

- High investment capital requirement limits number of qualified prospective franchisees
- Franchisor success and ROI from the market is highly dependent on the performance of a single franchisee
Direct Single Unit Development

• Not as common. Applicable when a single unit (vs. multiple units) develops a large part or entire metro market

• Requires unit revenue and royalty levels that justify market development and support costs

• Easier to apply in markets most similar to domestic market (e.g. Canada to U.S.)

• Examples: New Horizons Computer Learning Centers, Crestcom Intl. and some hotel brands
Direct Single Unit

Advantages

• Direct relationships with franchisees
• Same unit development model and (similar) support techniques as used in domestic market
• Full royalty income rate

Challenges

• Unit model size requirements for economic viability
• Lower financial leverage of international relationship(s)
• Direct support is often remote (ex: U.S support to Japan!)
  – Localization requirements and responsibilities
Master Franchise

- Effective for smaller franchisors; service brands and food brands with simpler menus
- Master Franchisee is granted exclusive rights to operate and sub-franchise units, usually on a national basis.
- Franchisor delegates development of system, network and brand to a master franchisee with local experience and resources
Master Franchise

• Requires clearly defined roles & responsibilities
• Initial Master Franchise Fee
• Defined revenue sharing model:
  – Initial Unit Sub-franchise fees, ex: 80% + 20%
  – Royalties, ex: 5% + 2%
• Development schedule
Master Franchise

Advantages

• Lower cost approach to developing markets

• Offers the potential for high paced market development

• Leverages master franchisee’s local experience and resources

Challenges

• High investment capital requirement limits number of qualified prospective franchisees

• Master franchisee must often learn two businesses – the unit model and how to be a franchisor.

• Less control of your brand
International License Due Diligence
Why International Licensee Due Diligence is A Must, Not An Option

• The stakes are higher
• The time investment is longer
• The monetary investment is higher
• Less time to reload after a failed attempt
• The pool of viable candidates is smaller
• Investigative resources are more scarce
• US government requirement
Why International Licensee Due Diligence is A Must, Not An Option

Office of Foreign Asset Control (OFAC)

As part of its enforcement efforts, OFAC publishes a list of individuals and companies owned or controlled by, or acting for or on behalf of, targeted countries. It also lists individuals, groups, and entities, such as terrorists and narcotics traffickers designated under programs that are not country-specific. Collectively, such individuals and companies are called "Specially Designated Nationals" or "SDNs." Their assets are blocked and U.S. persons are generally prohibited from dealing with them.
Why International Licensee Due Diligence is A Must, Not An Option

Senior Foreign Political Figure

Foreign Corrupt Practices Act (FCPA)

Financial Action Task Force on Money Laundering

Politically Exposed Persons (PEPs)

Anti-Bribery/Anti-Corruption (ABAC) Solutions

International Anti-Bribery Act of 1998

Standard Due Diligence Components

Financial Due Diligence

- Credit reports
- Personal financial statements
- Business financial records
- Bank statements
- Tax records
- Source of funds

It is not always possible to get all of this but get as much as you can!!!!
Standard Due Diligence Components

Reputational Due Diligence

- General business reputation
- Litigation history
- Criminal records
- Regulatory actions
- Negative press
- Watch lists
- Reference checks
Standard Due Diligence Components

Third-Party Vendor Due Diligence

• Who are their potential vendors, suppliers and partners?
• How long and how established are those relationships?
• Are any of the key relationships with family or friends?
• Can they scale to match anticipated growth?
• Where are these partners geographically?
Challenges of International Due Diligence

The Rule of 3s

- Regarding background checks, one or more of the following generally applies:
  - You will spend 3 times as much as you would on standard domestic background check
  - The process will take 3 times longer
  - You will yield 1/3 of the information you are accustomed to on domestic background checks
Tips for Success

• Give your self *more time* to complete the DD
• Be transparent with the prospects with regards to the DD process and what is expected of them
• Respectfully ask the prospects to produce information you cannot obtain through public sources, e.g.:
  – Copy of passport or National ID Card
  – Address history
  – Citizenship
Tips for Success

• With regards to references, obtain objective data wherever possible
• Ask the provided references for additional potential references
• Create a questionnaire for the prospect
• Consider taking the DD in phases as not to overwhelm the prospect with requests
• Look at the results of the DD in context and consider cultural differences before making judgments
Tips for Success

• Find **great** partners
  – Attorneys
  – CPAs
  – Consultants
  – Investigators
  – Respected industry colleagues
  – Local business contacts
Tips for Success

• Foster a culture of collaboration with your partners
• Some redundancies are ok though
• Share relevant information with all parties involved in the process
• Consider centralizing the aggregation of data
• Go broad and shallow if you can’t go narrow and deep
Sources For Due Diligence Help

- EGS “Going Global” Tools
- Transparency International - Corruption Perceptions Index
  - http://www.transparency.org/research/cpi/overview
- Thomson Reuters – World Check (fee/subscription based)
  - https://risk.thomsonreuters.com/products/world-check
- Factiva (fee/subscription based)
- U.S. Commercial Service (U.S. Dept. of Commerce)
  - http://www.trade.gov/cs/
- Heartland Investigative Group