Franchising joint ventures offer benefits

By Eric Parker

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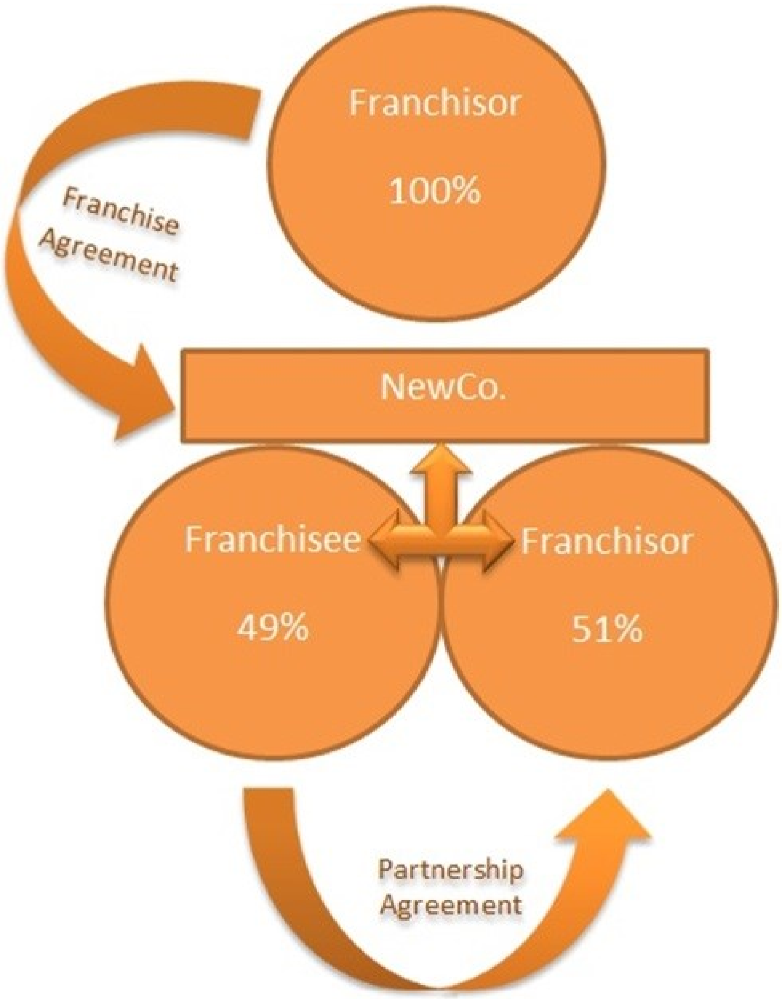
The joint venture is growing in popularity because it is a win-win mechanism that works well for the franchisor and the franchisee.

Many corporates have reservations about franchising because they believe they will lose control of their brand and not be able to implement change without buy-in from the franchisees. They do however acknowledge the benefit of an owner operator who will normally outperform an employee because he or she has 'skin in the game'. The JV mechanism is ideally suited to corporates and this is how it has been implemented successfully in big companies.



1. Assume the company has an opportunity to open and outlet in a new area. It can be opened as a company owned outlet, franchise or a joint venture.

2. Assume the company chooses a joint venture – what are the advantages for franchisors?

a) They keep control but have a motivated local partner with ‘skin in the game’. Having invested funds in the business, the joint venture partner will be motivated to succeed.

b) They only need to contribute 51% of the start-up capital. The joint venture partner will contribute the remaining 49%. If the business is financed, the initial equity contribution reduces further for both parties. However, the franchisor will need access to its share of the capital, so this is not a suitable format if the franchisor has a lack of capital. If that is the case, franchising makes more sense, as it entails expanding with third party capital and resources.

c) They receive the upfront fee from the NewCo, which is a franchise, as well as the royalty and marketing contribution.

d) They also receive 51% of the profits. This is one the main benefits of a joint venture, as the franchisor shares in profits and does not just receive the royalty/management service fee as compensation for its support.

e) They can cover themselves in the agreement for all eventualities eg if they want to sell the business or list the business, the agreement could stipulate partner must ‘come along’ or participate.

f) In time, the franchisor could consider selling its 51% stake to its partner and the business remains a franchise that is part of the overall footprint of the brand.

g) If the joint venture partner wants to sell, the franchisor can purchase the minority share at a predetermined multiple agreed in the agreement.

h) The franchise agreement and partnership agreement are extensive agreements covering all the possible scenarios.

3. The joint venture partner would contribute its share of the capital and be employed to be the hands on manager. As such, he or she would draw a market related salary. A predetermined dividend policy will be covered in the agreement.

4. From a legal point of view a joint venture would work as follows:

   a) Set up a ‘NewCo’ which will own the outlet?

   b) The NewCo would sign a franchise agreement with the franchisor.

   c) A partnership agreement would be signed between the joint venture partner and the franchisor, as partners in the NewCo.

5. Corporates often see the joint venture system as a good way to reward and empower loyal staff.

6. The joint venture is favourable from operating partners’ perspective because:

   a) They feel confident to have the franchisor as their partner.

   b) They do not always have the capital available to fund the entire business and would rather have the franchisor as a partner than an outside investor who does not understand the business.

c) They know that should they want to sell the business, the franchisor will most likely purchase the business at a predetermined profit multiple.

Therefore, in conclusion, the joint venture mechanism is gaining in popularity and could be a positive disrupter to franchising.

ABOUT ERIC PARKER

Eric Parker is a partner at Franchising Plus.

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