

A planned resales strategy - the last step of the way

By Derrick Simpson

From the point of the inception of a franchise, the objective of the franchisor is to build its network. The key focus is on franchisee recruitment and their training, launch and development because each recruit brings with it a tranche of new money, increased network sales and, therefore, increased management services fee revenue and brand presence.

This is, of course, how it has to be because it is only with an established network that the franchisor can recoup the true benefits and economies of scale of operating a business in this fashion - hands off from the end user. That's fine and just how it should be, but after a while, and sometimes a very short while, there will be the requirement to address the issue of franchisees wishing to sell on their businesses.

How then does this fit into the structured recruitment machine the franchisor has been operating? How does it advise its franchisee what to do? Should it even be bothered to become involved in the process, and does the franchisee have the right to sell to another individual anyway?

In the early days of franchising, this whole subject was fairly taboo with a certain amount of stigma attaching itself to the "R" word as it seemed to imply a failure of some kind. Even as recently as five years ago there was only a handful of franchisors, who had in place a process that allowed their franchisees to sell on with any form of certainty about what they were doing.

These enlightened franchisors had documentation and systems in place so the franchisee could look to them for advice and support at this challenging time, just as they had always done on operational matters during their life in the franchise.

We now have a franchise industry that is maturing and, whilst we see new franchised brands being established each year, there is a growing number of franchise systems approaching maturity and some whose networks are full as regards new recruits for new territories/locations.

For these, the selling of existing businesses is the only way forward for the particular brand. Either that, or they have to grow tangentially with the



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establishment of an additional brand, as opposed to expanding their current one, thus becoming a multi-brand operation.

Most established franchisors feel that to have a turnover of 10 per cent or so of their franchisees each year is vital to maintaining a healthy network as it constantly brings new blood and new energy into the business to help drive the network to the next level.

Often in younger franchises and sometimes in the very early days, a franchisee will ask to sell and the franchisor is simply not geared up for this to happen. Here necessity and expediency drives the process and often causes the creation of hybrid systems that once they become embedded in a franchisor's process can cause frustrations and problems in the future.

It matters not whether a franchise is young or mature, or still recruiting or full to capacity, the basic principles of ethical franchising mean franchisors should, as part of their operating processes, have a structured resale route available for their franchisees. This doesn't have to be fully resourced in-house because, as with other specialist functions, it can be outsourced. It certainly doesn't have to be a financial drain on the franchisor, nor does it have to be complicated or convoluted, it is simply a process that requires planning and implementing.

So where to start? Initially, the franchisor must ensure it has actually given its franchisees the right to be able to sell on their business; accrue a benefit from having operated the franchise; and realise the value of their efforts through a resale.

This means having a clause in the franchise agreement that specifically grants this right to sell on to a new franchisee. It is quite possible and indeed sensible to apply controls to the sale process and stipulate the hoops that both seller and purchaser need to jump through, but unless the right is there in the first place the process can become much more convoluted and even confrontational. Certainly for any franchisor, who entertains the thought of becoming a member of the BFA, it is essential to have such a clause in order to be granted accreditation.

The right to sell clause will set out the process the selling franchisee must follow; the fact that the franchisor will have the final say as to whether or not the proposed purchaser is acceptable to it as a franchisee; and will detail what charges, if any, the franchisor will make for this service and facilitating the change of ownership.

The charges and fees payable to the franchisor vary quite widely. Some use the resale process as an income stream and make it a profit centre in its own right, while others simply facilitate the process with little cost involved. I have seen all the following in various franchise agreements.

- A commission payment if the franchisor introduces the purchaser of either 2, 5, 10, 20 or even 25 per cent of the selling price.
- A transfer fee if the seller finds its own purchaser of either 1, 2, 5 or 10 per cent of the selling price, or sometimes a flat-fee structure, where the seller pays

a fixed sum. This also varies widely depending on the type of franchise from around £2,000 to £10,000.

- Joining fees for the purchaser, charged in either of two ways, depending on the view of the franchisor. Some simply wish to cover their training and induction costs, while others levy the full joining fee, regardless of whether the new franchisee is buying a new business or a resale.

There are various views within the industry on these charges and different solicitors and consultants, and the BFA, will all have their own opinions, but whatever is to be charged should be enshrined in the franchise agreement. A key point here is that if the franchisor is making a charge in a resale, it should be proportionate to the value and the wealth-generating capability of the business being sold.

Having granted the right to sell, the franchisor also needs a system for the franchisee to follow when the latter decides that this is what it wants to do. Franchising is about providing a business operating system in return for a fee, and franchisors make great play about the support given to new franchisees acquiring a greenfield opportunity from them. Where they tend to fall down is by not having a structured and detailed process for when the franchisee wants to leave through a business sale.

If the franchisor doesn't have a structured system, franchisees are left to sort out their own sales process and to a certain extent this is an abdication of the responsibilities of the franchisor. This is even more so when one can see how simple such a process could be and that it can be supported by external resources.

A well-structured resale process will include the following elements.

Guide to selling: This will describe the franchisor's process in practical terms. It will contain notes on how the franchisee should notify the franchisor that it wishes to sell, describe the valuation process and give guidance, list the information the franchisee will need to prepare, set out the arrangements for the franchisor's involvement, cover any fees that require paying and describe the legal completions process. There is no reason why such a document should not be included in the franchisor's operations manuals as a permanent part of its franchise system.

Prospectus of sale: This is where the franchisee writes about its particular business. The franchisor can have a templated version of this with a pre-written introductory piece about the franchise. This is the franchisee's sales document.

Independent valuation: This will allow the franchisee to get a realistic view of what it can expect to receive for its business because it will be based on the same information provided to purchasers and will be the basis used by the purchasers' advisers for their own valuation.

By having the prospectus of sale prepared in advance, and obtaining a valuation that is independent of the both franchisor and franchisee, means that two of the biggest stumbling blocks to success-

ful resales are reduced, if not totally removed. By having a detailed prospectus, the purchaser and its adviser will have all the necessary information at their fingertips. This saves the to-and-fro of initial discussions and will greatly add confidence that the proposed purchase is sound and all the information needed is available.

An independent valuation means that the initial asking price for the business will be broadly in the right ballpark. This avoids the gaping credibility gap which is the result of promoting a business for an inflated figure, when its actual value is considerably less. Overstated asking prices that bear no direct relationship to the true value of a business and are only set because the seller either needs the money, or has simply put a finger in the air are usually doomed to failure. This causes frustration in the franchisee who may turn to blame the franchisor for its failure to sell the business for them.

Businesses are valued on their ability to generate sustainable, transferable profits. Making an independent valuation part of the franchisor's resale process will ensure its franchise network will come to understand these principles and franchisees will be able to plan for their eventual exit well in advance.

Naturally, large premises-based businesses where equipment is involved are more complex to value than simple van-based operations, but this doesn't mean that the smaller ones should not be treated in a structured manner.

Sale and purchase agreement: This can also be structured or templated as part of a franchisor's system. Once the seller and its purchaser have reached an agreement on price there is usually a legal sale and purchase process to go through. This may not be so onerous for the simple van-based franchise sale, but for most transactions there will need to be an agreement document of some sort. Here again the franchisor can add value to its offering of support by having a pre-drafted agreement that contains the key parts of the agreement already in place. This will save time and, therefore, costs because each seller's solicitor will not have to produce a new sale and purchase agreement for each sale and the franchisor will also have retained a certain amount of control in the drafting. The form of the agreement should be as follows.

Part 1: This describes what is being sold, by whom, to whom, and for how much. Lots of blanks to be completed and totally non-contentious.

Part 2: This covers the sections pertaining to the franchisor's interest in the sale, surrendering one agreement and granting another, and the use of the name, etc. This section should be non-negotiable and not changeable by either party

Part 3: This section sets out a best practice approach to the seller's and buyer's relationship and can to a certain extent be changed and tweaked to suit them but, given that the purpose of having a pro-forma document is to minimise cost, too many alterations should be discouraged by having an equitable approach when drafting the initial document.

The sale of a franchise is a three-party affair with the franchisor also agreeing to the purchase by countersigning the sale and purchase agreement, along with the purchaser and the seller. It is in everyone's best interests that the document is well structured and drafted by suitably qualified BFA-affiliated solicitors.

Franchisees' life cycles within a particular franchise will be of varying length, but all need encouraging and nurturing as they join, develop and become established within the network. So it is with their leaving. Systems, support and advice delivered internally, or via third parties, will ensure that both franchisees and franchisors mutually benefit from a structured and efficient resale process on this last step of the way.

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