Protecting Working Capital Through an Improved Real Estate Strategy

BY SCOTT SIMCIK, CFE

The benefits of a franchisor partnering with an approved strategic real estate company are far greater than the risk and harm of referring a new franchisee to a third party national real estate firm or a local commercial agent.

For decades, the vast majority of franchisees, if asked, have said, "I invested substantially more money than I thought I would to open my franchise business. The working capital that I budgeted for my first year in business was used for excess rent, landlord capital improvements, tenant build-out costs, and construction overages."

Franchisees, however, don't have to be over budget. Opening a business within budget commences at the real estate pre-opening stage of a franchised business. Starting with a well-negotiated lease, a franchisee will not only substantially reduce start-up costs and protect working capital, but the franchisee will also have the opportunity to maximize profitability.

To obtain the ideal lease, franchisors and franchisees alike, must work together to understand the two main root causes that promote the most commonly used yet ineffective real estate approaches.

ROOT CAUSE NO. 1: LEGAL

A franchisor must not engage in conducting site search, lease negotiation or legal contract review services at its corporate offices. Franchise attorneys will advise franchisors to remain at arm's length from the franchisee real estate process. These activities cross the line of conducting real estate brokerage services without proper licensing. It also implies, by action, that a franchisor is controlling the final site selection decision on behalf of the franchisee, which conflicts with the contractual terms stated within the franchise agreement. Well intended, this can be perceived as over-reaching to estimate and project the revenue of a potential location.

ROOT CAUSE NO. 2: OPERATIONAL

Not knowing where your next franchise location will be placed forces a franchisor to default to real estate methods that do not yield the highest quality results. Franchisors struggle to predetermine geographically their next 10 franchise locations. It is too difficult to predict, in advance, from which city or state franchisors will receive a new franchisee inquiry and ultimately grant a franchise. In the exception, large established franchisors can predetermine where their next franchise location will be assigned.

These two root causes force emerging franchisors to rely upon the two most commonly utilized but ineffective commercial real estate approaches:

INEFFECTIVE REAL ESTATE APPROACH NO. 1:

The franchisor introduces a franchisee to a national commercial real estate brokerage firm.

- **Conflict of Interest.** A potential conflict of interest will occur if an agent within the local office promotes its own property listings and protects the financial interests of the landlord it represents through its companies listing contract.

- **Inexperience.** A franchisee may not have the confidence in the experience level of the local agent to whom they are being referred. With this agent's little to no prior experience with the franchisor's location and economic requirements,

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combined with different skillsets and negotiating capabilities, local listing agents struggle to execute a standard real estate protocol to maximize the quality, speed and savings for the franchisee location.

- **Bigger is not Better.** By the nature of their business, bigger is not necessarily better as larger firms are not set up to customize and serve a well-defined, daily real estate protocol. Their decentralized structure is not capable of consistently negotiating each franchise location, thereby decreasing the speed and savings of each franchisee. On the other hand, a master lease negotiator, centralized to negotiate each franchisee's lease will greatly improve the quality, speed, and savings of each franchisee location.

INEFFECTIVE REAL ESTATE APPROACH NO. 2:

The franchisor refers the franchisee to a local commercial agent within their market.

- **This is a "hit or miss" approach at best.** There is too wide a range of methodologies in location strategy and execution, customer service and negotiating skills among local agents to trust this approach.

- **Get in Line.** A franchisee's expectation is to be the highest priority. However, it is common for a local broker to be working on many other leasing assignments that have a higher closing priority, forcing the franchisee to slip to last on this list.

- **Short-Term Mindset.** With a limited assignment from a franchisor, local brokers often neglect the use of a long-term strategy. This can yield a short-term mindset of a local broker prioritizing his/her own best interests with a commission mind set, ignoring the franchisor and franchisee's requirements.

- **Time Kills.** A common result is a franchisee anxiously waiting up to six months to secure his/her favorite location, which ultimately falls out,causing intense frustration and the need to start over with the hiring of a new real estate agent.

Franchisors who promote and utilize these two referral-based broker approaches struggle to achieve the quality, speed and savings desired and expected within the goals set forth below due to the limitations of referred local brokers.

Franchisor Goals: A standardized location criteria, site search and selection strategy, and consistent execution. Protecting low to high square footage parameters. Protecting low to high rental schedules. Functionality of space planning. Opening safely and creatively under budget. (There are literally hundreds of smaller details that are developed and refined to manage the quality of your brand-specific real estate services.)

Referred local brokers, at a distance, have very limited brand-specific understanding, training, and supervision from the franchisor, which greatly impacts the broker's ability to achieve the franchisor's goals. Ten different brokers in 10 different markets working with 10 different franchisees yield 10 different outcomes.

Franchisee Goals: Identifying top three locations to leverage time and financial savings. Securing the highest quality location in the shortest amount of time. Reducing start-up costs through effective negotiations. Protecting monthly sales-to-rent ratios.

Referred local brokers who do not have a seasoned understanding of franchise culture will not properly manage the wide range of personalities, fears and anxieties which exists within each new franchisee assignment or understand how their customer service and financial results impact the franchisor's reputation with the franchisee. Additionally, there is a very low priority on the importance of reducing startup costs and protecting franchisee working capital.

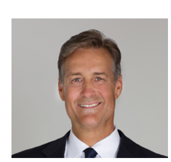
Business Model Goals: Maximizing high visibility with access and tenant mix. Recognizing the unique nuances of the required parking, patios, signs and other related special or conditional use permits or contingencies that must be managed concurrent to securing a location.

Referred local brokers struggle to get up to speed on the essential details of functional space planning, construction cost estimates, permitting and the unique economics aspects of the business model, which are vitally important to quality, speed, savings and long term profitability.

Landlord Goals: Maximizing monthly rental schedule. Minimizing landlord capital improvement investments. Minimizing tenant concessions. Minimizing build-out period and rent abatement.

Referred local brokers work for and are paid by landlords. These competing interests do not align in the best interests of a franchisee and will serve to protect the agent's long-term interest in the local market with other real estate brokers and landlords through overemphasizing to a franchisee the term "market rates" and that his landlord doesn't offer these rates and concessions. If local brokers are too aggressive in protecting a franchisee's financial interests, they take the risk in hurting their political and personal reputations within the local market. Thus, their political interests become more important than your franchisee's interests.

The benefits of a franchisor partnering with an approved strategic real estate company are far greater than the risk and harm of referring a new franchisee to a third party national real estate firm or a local commercial agent. Customizing a standardized real estate protocol delivers franchisees consistent site search and selection, lease negotiation, and legal review. ■



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