

# Buying a Business or Franchise

- Welcome!
- Goals
  - Get educated on buying a business or franchise
  - Understand if business ownership is for you
  - Equip yourself with the tools you need to explore options



# Big Picture

- 1,900,000 households in Minnesota
- 124,000 businesses
  - 107,000 of these are small businesses (<20 employees)

*(Source: InfoUSA)*
- Only 5% of Minnesota households are business owners
- According to the Small Business Administration (SBA), small business generates 50% of Gross Domestic Product and employs 50% of the nation.



# Should You Join the Five Percent?

- What is your motivation?
  - Income replacement
  - Corporate burnout
  - Investment
  - Growth through acquisition
- Are you independent?
  - Most people will tell you NOT to buy a business or franchise
- Are you willing to take risks?
- Are you a visionary?
- Do you have the financial resources?
- Do you have the right experience?



# Buying an Existing Business

- Benefits
  - Immediate Revenue and Cash Flow
  - Proven Products or Service
  - Established Brand/Reputation
  - Trained Employees
  - Vendor Relationships
  - Training from the Seller
  - Control
  - Financial Reward
  - Build Long Term Equity



# How to Find the Right Match

- FOCUS ON YOUR RESOURCES (Financial, Experience & Skills)
- Stay open minded on industry
- Sometimes it is easier to identify the type of business you know you would NOT buy
- Seek a business where you have transferable SKILLS
- Most owners will provide significant training
- Flexibility on location could reveal a great business and in some cases even a business that can be relocated



# How to Find the Right Match – Earning Power

- The earnings of the business must do three things:
  - 1) Pay the new owner's minimum salary needs
  - 2) Service the acquisition debt
  - 3) Have a “cushion” to allow for working capital, capital expenditures and investment back into the business to drive growth (most banks like a 20% “cushion”).



# Determining Earnings for a Small Business

- Most business owners do their taxes to NOT pay taxes
- Net income on the tax return never tells the whole story
- Seller's Discretionary Earnings (SDE) measures the true earning power of a business
- SDE includes:
  - Net Income
  - + Depreciation and Amortization Expense
  - + Interest Expense
  - + Owner's Salary
  - + Owner's Discretionary Benefits
  - + One Time Expenses (or minus One Time Income)



# SDE

- SDE allows for an apples to apples comparison of the earning power of businesses:
  - Example 1: Net Income of \$100,000
  - Example 2: Net Income of \$0



## SDE – Recasting

- SDE allows for an apples to apples comparison of the earning power of businesses:
  - Example 1: Net Income of \$100,000. Owner takes a salary of \$100,000. Depreciation of \$50,000. \$0 Interest. \$0 Perks.
  - Example 2: Net Income of \$0. Owner takes a salary \$300,000. Depreciation of \$50,000. \$0 Interest. \$50,000 Perks.



# Multiples

- Since most businesses sell for a multiple of SDE, understanding SDE is key
- What are you really buying? The future!
- How likely is it that the revenues and SDE will continue into the future?



# Multiples are Driven by RISK and GROWTH



Growing Industry  
Proprietary Product/High Barriers to Entry  
Strong Brand  
Intellectual Property / Patents  
Consistent Revenues and Earnings  
No Large Customer Concentrations  
Management in Place



Inconsistent Revenues and Earnings  
Heavily Dependent on Owner  
Low Barriers to Entry  
Few Assets  
Mature or Declining Industry  
Large Customer Concentration(s)  
Low Repeat Customer Factor



# Multiples

Main Street business multiples can range anywhere from 2 – 5+ times SDE, depending on Size, Industry, Risk and Growth factors.

Two Service businesses with the same revenue and earnings (SDE) might sell for much different prices depending on their customer concentration, market share, staff, intellectual property, years in business, reputation, management and other Risks and Growth Opportunities.



# Terms

- Most sellers want to be cashed out
- However, seller financing is very common
- Some sellers will finance a majority of the deal to:
  - Show confidence in the future of the business
  - Tax deferral
  - Interest earnings
- **IMPORTANT:** The seller is also the bank. Demonstrate why you are a good credit risk!



## LEVERAGE: Seller Financing and SBA Financing

- Seller Financing deals (no bank) typically require a much larger down payment from the buyer (30% - 80%).
- SBA financing gives a buyer more leverage with down payments around 20%. SBA financing is not easy to get.
- \$200,000 of buyer capital gets you...



# SBA vs. Seller Financing

Financing	Buyer Equity	Bank Financing	Seller Financing	Closing Costs/Time	Buyer Equity Leverage
SBA	20%	70%	10%	Yes	More leverage, 5:1
Seller	30-50%	0%	50-70%	Minimal	Less Leverage, 2:1 – 3:1



# Sources of Capital

- Cash
- Home Equity
- Securities
- 401k
- Lenders (SBA)
- Seller



# The Process of Acquiring a Business

- Meet face to face with a business broker and communicate your goals
- Sign a Confidentiality Agreement and review businesses that match your goals AND resources
- Select businesses that meet your criteria and arrange to meet with the seller to ask questions (reason for sale, transition, trends, growth opportunities, risks, key employees)
- Use Contingent Offers to control your legal and accounting costs
- Specify Contingencies (due diligence, financing, lease)
- Get help from an attorney and/or accountant who understands your goal is to buy a business and is well versed in business acquisitions (10 or more done deals)



# Summary & Questions



# John Groppoli – Buying a Franchise

- 900,000+ Franchised businesses in the US
- 11+ Million jobs
- \$2.31 Trillion in total economic output



# Buying a New Franchise License

- Benefits
  - Immediate Revenue and Cash Flow
    - Lower initial investment
  - Proven Products or Service
  - Established Brand/Reputation
  - Trained Employees
    - Hire who you want
  - Vendor Relationships
  - Training from the Seller
    - Training from Franchisor
  - Control
  - Financial Reward
  - Build Long Term Equity
    - When it comes time to sell reward yourself for the cash flow that you have built up!



# Buying a Franchise - Agenda

- Define Franchise
- Franchise Myths
- Investment
- Industries With Franchise Opportunities?
- Why Consider A Franchise?
- Are You A Franchise Candidate?
- Finding The Right Franchise



# What's a Franchise?

- Share trade name
- Share Operating methods
- Provide exclusive territory
- Collect an ongoing fee



# Franchise Myths

No Freedom in a Franchise –corporate dictates everything!



# Franchise Myths

FALSE!

- Franchisor dictates the basic system—the framework—that's already proven successful.
- You are in charge!
- Hiring/Firing
- Marketing and Promoting Business regionally



# Franchise Myths

Franchises Stifle Creativity



# Franchise Myths

FALSE!

- Franchisor needs franchisees to follow their core system because it has been proven to generate income!
- Franchise owners have the ability to think up new ideas and make suggestions to corporate...strong brands encourage it!
- McDonalds corporate didn't come up with the inspiration to start selling breakfast...concept of the Egg McMuffin was developed by a franchisee



# Investment

- Franchise Fee
- Total Investment
- Royalty
- Ad Fee



# Industries?

All Industries!

*1 out of 9 businesses - Franchise*



# Why Consider a Franchise

“Be in business for yourself, but not by yourself”

“Learn from the success and failures of others.”

“Franchising is a process of bottling success and giving it to other people for use in developing their own successful businesses.”



# Why Consider a Franchise

- The U.S. Department of Commerce states that 90% of franchises are still in operation after 10 years, compared to just 18% for other forms of small business.



# Why Consider a Franchise

- Proven Model/Systems
- Solid Training Program
- Ongoing Support

**\*BUILD BRAND\***



# Investment Options

- Single License
- Area Development
  - Purchase multiple licenses and own/operate each location
- Master Franchisee
  - Purchase rights to whole state
  - Sub-Franchise



# Are You a Franchise Candidate

- Can you follow a system?
- Relationship Builder?
- Like to minimize risk?
- Big Picture Thinker?



# Finding The Right Franchise

- Over 3000 different franchise companies and growing
  - Where do you start trying to find the right fit for YOU?



# Role of Franchise Consultant

- Help buyer efficiently zero in on models that meet their criteria
- Define the buyer's Criteria
  - Income Goals
  - Lifestyle Goals
  - Passion
  - Investment
  - Location
- Present franchise models
- Help buyer navigate thru the exploration process



# Franchise Evaluation Process

- Complete Confidential Profile online
- Initial Consult
- Discuss models that meet criteria
- Have initial call with franchisor
  - Receive FDD
- Have follow-up call with franchisor
- Validation calls
- Discovery Day



# Common Questions

- How to determine revenue potential?
- How are you compensated
- What do I get for the royalty



# Top Ten Mistakes Buyers make

- 1) Going it alone
- 2) No Written Plan
- 3) Understanding purchasing power and income requirements
- 4) Lack of Working Capital
- 5) Making decisions only based on numbers
- 6) Not willing to take leadership role – not giving financial info
- 7) Failure to ACT! / Analysis Paralysis
- 8) Buyer doesn't follow the acquisition process
- 9) No validation calls (Franchise) / Inadequate Due Diligence
- 10) Post Closing: Changing the business before understanding it

