How To Select The Right Private Equity Partner For Your Franchise Brand

David Chapman

I started my franchise marketing services agency in 1996. Today, it's a nationally acclaimed agency. Like many other franchise brands, I explored partnering with private equity groups to accelerate our growth, and of course to also extract some of the value built through the years.

The process was exciting, challenging and all-consuming. I evaluated dozens of potential investment firms before deciding on the right partner. In the end, the decision was not based on the highest financial offer; it was driven by the chemistry between our respective leadership teams and a shared vision for dominating the U.S. franchise marketing services sector.

Even so, I was fully aware of the issues associated with PE firms like unrealistic EBITDA goals, incessant status calls and excessive cost-cutting coupled with large revenue growth projections.

All articles written by David Chapman. david@davidchapmanonline.com 919-427-4917.

The Acceleration Of PE Deals In Franchising

It is no surprise that private equity groups are aggressively investing in the large and lucrative franchising model. According to the International Franchise Association, the total output of franchised businesses in 2023 was $858.5 billion.

There are two distinct private equity franchising investment strategies: investing in the parent company (the franchisor) and purchasing a majority stake in local franchisees of various franchise brands. Both offer attractive and predictable revenue streams and, if fully capitalized, can generate impressive growth rates.

PE firms are attracted to franchisor brands due to strong national or regional brand recognition and consistent royalty streams, and in many cases the ability to securitize future royalties.

On a local market level, PE can work both vertically and horizontally to build a powerhouse portfolio of franchise brands. For example, PE groups have acquired a critical mass of locations of one brand and/or multiple brand locations in similar sectors (e.g., fast-casual restaurants) and reaped impressive back-office efficiencies.

With that as a backdrop, here are five tips to help you select the right PE partner for your franchise brand.

1. Get Qualified Help To Structure The Right Deal

You are receiving emails and phone calls constantly from potential investors. I understand the temptation to negotiate the sale on your own behalf versus hiring an investment banker or another qualified third party. However, in my experience, an investment banker has the time, resources, network and connections needed to manage the due diligence process, identify and interact with potential buyers, and structure and negotiate the transaction for your best interests. Make sure you get the qualified help you need to make the best deal.

2. Make Sure Your Values And Vision Align

My agency's values and vision were key discussion points in our early due diligence discussions with potential investors. Our vision of becoming "the most loved and most profitable franchise marketing agency in the country" was also in perfect alignment with the private equity group we partnered with. Coincidentally, one of our investors is also a multiunit franchisee.

Some evaluation factors to consider in your due diligence of PE firms include their track record of success with similar or "like" companies, the credentials of your designated day-to-day contact, board member composition and the financial resources to help accelerate the growth of your company.

3. Consider The Level And Nature Of Involvement

Make sure the PE firm you select plans to be involved at a level you're comfortable with.

Our firm was actively involved in recruiting a chief financial officer with experience working with PE firms and lenders. They provided valuable offshore resources in the areas of market and competitive research. Moreover, they have actively brought potential acquisition candidates to the table—leading to the acquisition of four add-on companies to our platform to date.

However, they are not micromanagers. They trust us to operate a high-performing company that is measured by mutually agreed-upon key performance indicators.

4. Ensure There's Team Chemistry

The relationship between the PE group and your leadership team should be centered around candid, productive debates about the business issues facing the company. An “if not, why not?” mentality encourages new ideas to bubble up and shows mutual respect for the talents and skills that different team members bring to the table.

However, you can’t fake chemistry. You are in a large investment together that will impact families for generations. Can you have a genuine nonbusiness conversation? Do you know their family stories and their passions outside of work?

5. Think About Governance And Planning For Future Roles

I recently transitioned from the CEO role to chairman of the board. My agreement included a board position that allows me to play an active role in the strategic direction of the company. Now I can squarely focus on being an advisor and advocate for the new CEO and spend more time positioning the company for strategic acquisitions and potential liquidity events.

If it's your time to find an investment partner to accelerate the growth of your successful franchise business, make sure you are prepared to maximize your value with a trusted advisor in your corner. However, don't lose sight of the fact that after the transaction, you will be on the next journey of positioning the company for future sale. Do you have the fire in your belly to work long hours and handle the stress of high expectations and potential acquisitions after your bank account has more zeros in it?

After the dust settles, it's all about the relationship you have with your fellow investors and the expectations you set. Are they world-class partners with the resources you need to succeed? Will they provide you with the "smart money" advice and resources you need to operate the company? Do you have a personal transition plan as the business grows and priorities change?

If you get it right, it will be an amazing journey. Make sure you make the right move at the right time with the right investment partner.

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