5 keys to successfully sell your franchise system

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Though it doesn’t happen often, some franchisors start a franchise system with the goal of selling it in the short or medium term. However, the quality of the infrastructure required to build a viable franchise system and the amount of resources (financial or other) that need to be invested over time is likely to lead such franchisors to reconsider their initial goal and either develop a strategic partnership or simply cave in and sell their franchise system to a competitor.

Given that a potential partner or buyer will likely carry out due diligence to substantiate the business opportunity, it is preferable to determine what issues may compromise or interrupt negotiations and try to resolve them in advance.

Identifying issues in the relationship with franchisees and making the necessary adjustments

Before thinking of selling all or part of your franchise system, you should assess the quality of your franchisees and your relationship with them. If you have conflicts with some of them, it is high time to resolve them. Unless faced with an isolated case that you have already taken steps to resolve, your potential partner or buyer may react negatively upon learning that some franchisees in your system are critical of the franchisor and may fear the impact that claims could have on the franchisor’s image, concept and brand.

The most frequent criticisms against franchisors are related to a lack of support and collaboration, a lack of transparency in the use of national advertising funds, a concept and/or operations that aren’t viable, and the belief that the franchisor does too little for its franchisees.

To learn if your system harbours any such criticisms, you should not visit your franchisees only to assess the quality of their operations. You should give them the opportunity to openly discuss the challenges and situations they face with your management team. It is always better to get franchisees to confide directly in their franchisor rather than letting dissatisfied franchisees discuss their points of contention between themselves.

A better understanding of the state of your franchise system will make it possible for you to be more transparent in disclosing the issues underlying a potential transaction to your prospective buyer. Even if such transparency may lead to a lower sale price, it avoids the financial consequences of incomplete or inaccurate representations that you may make to the future buyer and helps to maintain trust.

Reviewing and structuring documentation

As part of its due diligence, the buyer and its lawyers and financial advisors will review all key aspects of the franchisor’s system, including contracts (franchises, leases, suppliers, etc.), intellectual property and accounting. Missing or incomplete documentation will likely discourage the buyer and justify a reduction in the sale price, or, even worse, withdrawal from the proposed transaction.

It is therefore essential, before the buyer's due diligence begins, that you instruct your resources to verify that your documentation is compliant and reliable, correct any deficiencies and obtain missing information, if any, even if it means hiring external consultants.

Compiling your system's financial information

A potential buyer will undoubtedly want to analyze your financial statements and tax returns. It is also very likely that it will want to consult accounting records and verify some key performance indicators. Thus, your system's monthly sales (compared to those of previous years), geographic trends, how profitable franchisees' operations are and how frequently they pay their royalties will certainly be of interest to a buyer.

In addition, a diligent buyer will pay close attention to a franchisor's contractual obligations towards third parties, such as lessors and suppliers, and any warranties that it may have made to third parties. In short, full and structured disclosure of the financial information underlying your system will make it easy to demonstrate future profitability.

Negotiating an advantageous Earn-out clause

Negotiating the sale price of a franchise system can be done in different ways.

In addition to the traditional EBITDA valuation of the business, it is not unusual for a franchisor (whose management will ensure an operational transition after the sale) to negotiate an upward adjustment to the sale price should the franchisor achieve, after a determined post-transaction period, better financial results than those on which the buyer based its valuation of the sale price (the "Earn-out").

For example, the sales agreement could provide that a sum equal to the increase in EBITDA that the franchisor achieves during the Earn-out period, multiplied by the EBITDA multiple applied to the transaction, be paid in addition to the sale price.

Limiting the chances of your transaction failing by choosing a suitable buyer

Make no mistake: a transaction isn't concluded upon signing a letter of intent. There's still a long way to go. A multitude of conditions in favour of the buyer generally need to be fulfilled in order for the transaction to proceed. Stipulated time limits often need to be extended by mutual agreement for the parties involved to cover all bases and close the sale.

This doesn't mean that you must consent to all the buyer's requests to extend time limits. While delays in a transaction are usually well-founded, sometimes a buyer tries to buy time in order to exert pressure on the seller, or it will do so to finish due diligence that it deliberately made more complicated in order to find arguments justifying a decrease in the sale price./p>

To avoid such an unfortunate situation, it is in your interest to be well informed about your potential buyer and how it handled past transactions.

To assist you and make the best of your business model, feel free to contact a professional of our team!