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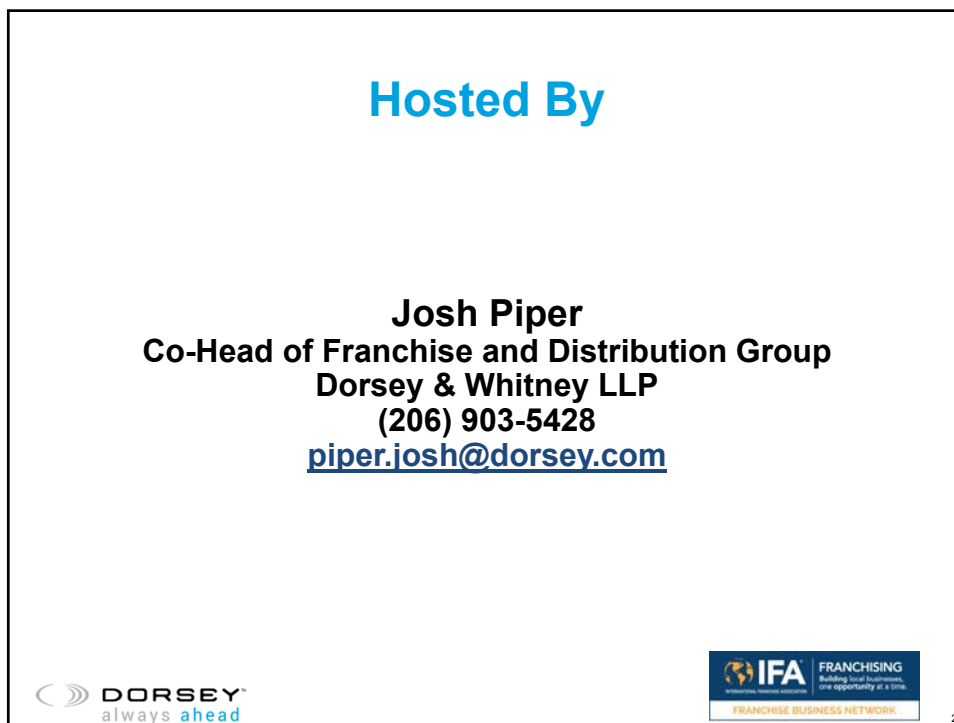
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How Much Can I Make? Sharing Financial Metrics with Candidates, and New and Existing Franchisees

Fall 2017 IFA Franchise Business Network
(FBN) Meeting


October 30, 2017


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Hosted By

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2

IFA Membership



3

Women's Franchise Network



**“Meet and Greet”
Following the FBN Program**



4

Sharing Financial Metrics with Candidates, and New and Existing Franchisees

AGENDA

1. Financial Performance Representations – Recent Changes to Item 19
2. Coaching Franchise Candidates in Financial Performance
3. Capturing and Leveraging Good Financial Data



5

Speakers

Josh Piper is Co-Head of the Franchise and Distribution Group at Dorsey & Whitney LLP, where he advises domestic and international businesses in a broad range of franchising, licensing, and distribution matters.

Jeff Levy is a coach, author, educator and has been coaching in the Seattle area for 15 years and has helped well over 290 people sign franchise agreements. He is the 2017 Visionary Award winner in the TES broker network.

Barbara Nuss, CPA is the owner of Profit Soup, which provides business owners and managers with practical tools and techniques to achieve greater control over the financial future of their companies.



6

1. FINANCIAL PERFORMANCE REPRESENTATIONS – RECENT CHANGES TO ITEM 19

Josh Piper



Financial Performance Representations What Are They?

- In the Beginning.....there were “earnings claims”
- Current FTC Rule: Any representation, including any oral, written, or visual representation, to a prospective franchisee, including a representation in the general media, that states, expressly or by implication, a specific level or range of actual or potential sales, income, gross profits, or net profits.
- Explicit: “earn a \$10,000 profit” – “sales volume of \$250,000”
- Implicit: “100% return on investment within the first year of operation”



8

Financial Performance Representations Why Should I Care?

You will be interacting with FPRs more and more

- Huge increase in use by franchisors since 2008
- Increased variety in types of FPRs
- The market (franchisees) are demanding them
- Today more than 50% of systems provide them

FPRs must be done correctly, or else!

- Complicated rules
- Significant liability for any “franchise seller” that is not in compliance



9

Key Requirements for FPRs

- Franchisor must have “a reasonable basis” for the information provided
- There must be written substantiation for the FPR at the time made
- Must disclose the material bases underlying the FPR
- The information must be included in Item 19 of the FDD



10

What is “a reasonable basis”

No statutory definition – not practical

FTC/NASAA guidance impose certain requirements
and give indications of what is not a reasonable basis

Regulators’ Perspective

- The figures should be based on results that have recently been achieved in the same system
- The results should be possible to achieve in the future
 - Based on models that are still being offered
 - Based on economics that still exist for franchisees today



11

New NASAA FPR Commentary - Overview

- Background
- Effectiveness
 - For franchisors having an FDD with an effective date between May 9, 2017 and November 4, 2017, and for franchisors with fiscal year ends of May or June, the Commentary is effective on November 4, 2017.
 - For all others, it is effective 120 days after their fiscal year end.
- Some state examiners have been using as guidance for 2017 renewals
- Presumption that FPR changes for one state should be made for others (FTC FAQ 38)



What Admonitions or Disclaimers Can I Use?

- **No variance in prescribed admonition language**
Some [outlets] have [sold] [earned] this amount. Your individual results may differ. There is no assurance that you'll [sell] [earn] as much.
- **Clear and conspicuous = separate paragraph, bold type**
- **No CAPITAL LETTERS, SMALL CAPS, underlining or larger type**
- **No disclaimers or waivers**
 - But per FTC Compliance Guide, seek “alternative ways to narrow [your] disclosures to avoid making misleading statements”



We Use Averages in Item 19. Has Anything Changed?

- **If you report an average, you must also include the median**
 - 13, 13, 14, 19, 26 Average: 17 Median: 14
- **You must include the high and low figures from the set**
- **Closed outlets: if closed outlets are excluded from the average/median, disclose how many closed after being open less than 12 months**
 - These closed outlets may be lurking in the set of outlets that are excluded because they were not open the entire year of measure



What Guidance Is There About Subsets?

- Subsets are generally okay, as long as the FPR has a reasonable basis, is accurate, and not misleading
- Geographic subsets require explanation and cannot be misleading

Limitations:

- Subset based solely on performance is not reasonable
- Best performers subset requires a corresponding lowest performers subset
- Must have at least 10 outlets to base an FPR on a subset



Can I Use Data of Company-Owned Outlets Only?

- **Defined Terms in the Commentary**
 - Company-owned Outlet
 - Operational Franchised Outlet
 - Gross Sales
 - Gross Profit
 - Net Profit
- **Define Your Item 19 Terms**



Company Outlets Only? Gross Sales FPR:



- **NO:** Franchisor with any operational franchise outlets (as of its last FYE)
- **YES:** Franchisor with no operational franchise outlets, with:
 - Reasonable basis for the FPR; and
 - Describes the material financial and operational differences from franchised outlets



Company Outlets Only? Gross Profit or Net Profit FPR:

- **YES:** All franchisors may make a GP or NP FPR, as long as:
 - Reasonable basis for the FPR;
 - FPR includes actual costs incurred by company outlets;
 - FPR includes adjustments and supplemental disclosure for material financial and operational differences from franchised outlets.
 - **BUT,** if there are operational franchised outlets, must also include their gross sales data.
- **Adjustments and supplemental disclosures must be in the same format as the rest of the FPR.**



Can I Merge Company and Franchised Data?

- **First disclose separately, then combine if useful.**
- **Exception: merging data is allowed to protect identities when:**
 - Small number of franchisees (no more than 10); and
 - Gross sales of company-owned and franchised outlets are not materially different.
 - Franchisor must include a representation to this effect in Item 19



Examples of Recent FPR Problems

Surveys

- **A sufficient percentage of franchisees to be representative**
- **Reasonable confidence that the information is accurate**
- **No better source of information**

Combining Information

- **A problem when the results differ significantly**
- **Multiple territory franchises with single territory franchises**
- **Limited service locations with full service locations**
- **Geographic location, age of outlet, and other factors differ – combining information may be permitted if the factors are explained and the factors are reasonable.**



20

Examples of Recent FPR Problems

Incomplete Information

- Specific information required by FTC Rule
- Required NASAA admonition (YMMV)
- Define your terms



FPRs in Advertising

- Reasonable, truthful, and substantiated
- Specific information required by FTC Rule
- Clear, conspicuous admonition
- Details must be in Item 19
- Any information prohibited in Item 19 would be prohibited in an advertisement (such as disclosing only the top X%).



21

2. Coaching Franchise Candidates in Financial Performance

Or, “How can I predict the future performance of my chosen business.”

Jeff Levy



22

Client Expectations

- Franchisor will be transparent on all numbers
- Income and ROI performance will be available in some form, sometimes from third party
- Franchise sales people will answer direct questions on financial performance
- Show me the highest financially performing franchisors
- Where/how do I start to get financial projections to support a go/no go decision



Reality vs Expectations

- Only 50% of franchisors provide an earnings claim
- It often represents company stores with lengthy history
- Often omits local circumstances and has wide ranges (rent/wages)
- Common that earnings claims are really not earnings but sales and gross margins
- Typically do not speak to below the cogs line
- Client needs to build their own model, prior to signing franchise agreement (often required for financing)



Good Franchise Choices are made on #s

- **Business planning is a challenging concept to someone who has never done it before (most don't have that discipline in their resume)**
- **Assumptions drive the proforma, balance sheet and cash flow: an educated guess based on the best information you can get including your prior experience.**
- **Prospects need data in an environment that restricts what they can get**
- **What to do?**



Coaching to a good conclusion:

- **Start with the CEO mindset**
- **Understand item 19**
- **Get a work sheet from the franchisor (blank but has line items)**
- **Know what questions to ask on validation calls**
- **Get local professionals to help confirm assumptions such as rent and labor costs.**
- **Identify franchisees in the system that are open to reviewing their #s**
- **Ask franchisor to provide contact names with expertise in the needed areas**
- **Remind them that a business is not an FDIC insured certificate of deposit**
- **There is a clear relationship between “educated risk” and “calculated reward.”**



3. Capturing and Leveraging Good Financial Data



27

Barbara Nuss, CPA

- **Capturing Good Financial Data**
 - Your basic stock
 - What to measure
 - Keeping it accurate
 - How to analyze it
 - What to share
- **Leveraging it with**
 - New and existing franchisees
 - Franchise execs




28



The Basic Stock

Here's the situation

- Owners struggle with the numbers side
- Little financial or management experience
- Lacking accurate financial information
- Non-compliance with financial reporting requirements



29

Does Your Culture Drive Business Improvement?



THE ACT OF MEASUREMENT IS A SYMBOL OF CHANGE.



30

What do you Benchmark? What do you Share?

- ✓ We don't share any system-wide benchmarks
- ✓ Averages, not individual performance
- ✓ Sales information
- ✓ Selling metrics (CRM leads, conversions, etc.)
- ✓ POS: Sales, cost of goods sold, gross profit
- ✓ P&L's to net profit (annually, quarterly, monthly?)
- ✓ Full financials including balance sheet

TO DO:

Make lists of metrics you collect.
Which do you share? How often?
What additional metrics would you like to benchmark?



31

Start With the End in Mind

Why are you here?



What Should You Measure?

Have you defined what should be measured in each area?

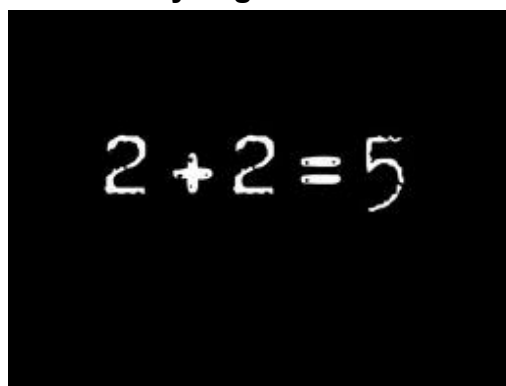
- Productivity
- Profit
- Cash Flow
- Financial Strength



33

Keeping It Accurate

Just how much time should you spend analyzing bad data?



34

Keeping It Accurate

- ✓ **Get started early – new franchises and conversions**
 - ✓ Standard chart of accounts
 - ✓ Monthly accounting procedures/checklist
 - ✓ Recommended monthly financial packet
- ✓ **Make regular financial reviews part of your model**
 - ✓ Consistently collect financials and review results
 - ✓ Educate field support about financial conversations
- ✓ **Provide accounting support/tips for accurate books**
- ✓ **Develop data integrity routines**



35

Data Integrity Routines

- ✓ **Outliers – high and low margins, etc.**



- ✓ **Balance sheet items that don't change**
- ✓ **Current portion of long-term debt**



36

Less is More

1	Gross Pr
2	Total Rev
3	Staff Cos
4	Staff Cos
5	Current F
6	Debt to V

Financial Year 2/31/2017	
C	RESULT
00	69.2%
00	\$107,143
00	\$32,833
00	26.3%
00	1.7
00	0.7

A picture is worth 1,000 words.
What's on Your Dashboard?

Technology Choices

Database

You pull data electronically
They push data electronically
They enter to online interface
They submit form
They submit paper/pdf financials

Goals: Ease compliance and accuracy

Subsets: How Do You Segregate Data?

To assess franchisee performance

- Sales volume
- Profit quartiles
- Region

To assess corporate initiatives

- Single/multi unit
- Marketing packages or adoption tiers
- Peer group members
- Field support member



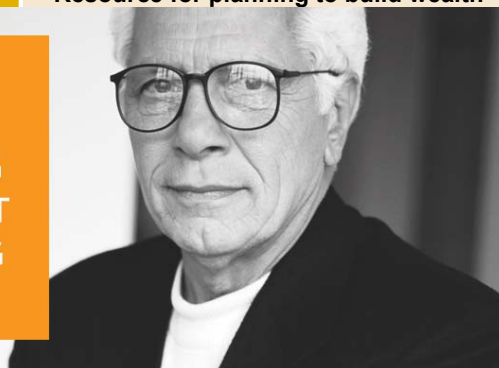
39

Benefits of Benchmarking Full Financials

Franchisee

- Resource for planning to build wealth

IF THE
NUMBERS
ARE BORING
YOU'VE GOT
THE WRONG
NUMBERS.



Franchisee
sees

Recruitment



- Demonstrates commitment to profitability



40

Creating a Successful Benchmarking Initiative

Commitment	<ul style="list-style-type: none">• Executive team• Support team• Franchisees
It's a Process, Not an event	<ul style="list-style-type: none">• Continual improvement• Focus support, education and communication on profit
Face Problem Areas	<ul style="list-style-type: none">• May highlight weaknesses/blind spots• Commit to improve at network <i>and</i> franchisee level
Reward Improvement	<ul style="list-style-type: none">• Recognize franchisee profit and productivity; not just sales• Align corporate staff goals and incentives with franchisee engagement and improvement

41

CFE Course – ProfitSoupOnline.com Benchmark Your Franchise Business

Includes 8 steps to
better benchmarks

PROFIT **S O U P**
ONLINE

Thank You! – Questions?

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43