



The Multi-Concept Operating Company (MCOC) 2008

A Franchise Consulting White Paper

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About the Author—Robert A. Needham, JD

Robert A. Needham, JD is President of FranchiseInc!, LLC an international franchise consulting firm based in Pelham, Alabama (Near Birmingham). FranchiseInc! offers a wide variety of services to the franchise community including: 1) franchise development of new business concepts, 2) strategic planning and business coaching to existing franchisors, and 3) as franchisor to our Franchise Consultant Network, we assist consumer wishing to purchase a franchise find a matching concept.

After completing a highly decorated military career that included being a member of the National Aeronautics and Space Administration (NASA) National Space Transportation System (Space Shuttle) Powered Flight and Assent Design Team, Dr. Needham has spent over 20 years assisting hundreds of small to large business owners develop their strategic business plans, product and service offerings, home office operations concepts, technology, as well as sales and marketing strategies. With a BS in Mathematics and Computer Science and a Juris Doctor, Dr. Needham has authored several books on franchising, business, financial, personal and life planning; numerous manuals, white papers, seminars, training materials and texts and is often sought as a public speaker, university guest lecturer, and concept advocate.

Dr. Needham’s most recent book, [Solving The Puzzle Of Owning A Franchise](#) has met with tremendous consumer interest. Dr. Needham has presented his ideas and concepts on television, more than 400 talk radio stations in the United States, and numerous business publication articles. Often seen as an industry innovator he has developed other brands such as FranTools.com, TheDeadLeadExchange.com, CollectRoyalty.com and others for client companies.

Executive Summary

High Net Worth Investors Seek Businesses That Offer Cash Flow Opportunities – A New Innovation In Franchising Called The Multi-Concept Operating Company (MCOC) May Meet This Demand.

Recent economic conditions have caused an increased spike in mid and upper management downsizing. These executives are seeking business ownership in lieu of new postings with employers. The combination of severance packages and the ability to use 401(k) and IRA funds via ERSOP (Entrepreneur Rollover Stock Option Plan)¹ provides an excellent source of start-up capital.

As Baby-boomers continue to age and mid to high-level executives seek post retirement opportunities approximately \$1 Trillion of new capital is seeking diversification away from more traditional investments such as mutual funds, stocks and bonds.

Industry Indicators

According to most industry sources, there are more than 3,500 franchise concepts in the United States today. FranData, as industry keeper of statistics, recently was quoted that more than 779 new concepts entered the marketplace in the past three years and more than 33,000 franchise units were added in 2006 (over 90 per day)².

A quick review of Entrepreneur's Franchise 500 for 2007 (page 176) showed No. 500 having only 37 franchises. While this is not a complete indicator it would lead one to conclude that maybe 75% (2,000 – 2,500) of all franchisors (3,500+/-) have less than 100 operating units with the majority of them having 50 or less!

In our study of the industry for the last 20 years, we have concluded that one of the primary reasons for stunted growth in the franchise industry is not the 80/20 Rule³, but more likely that

while franchisors in general know how to operate their concept, they do not either have the budget to hire the requisite talent to sell their franchises or they simply just don't know how to sell franchises. This is not being critical, it is just reality. As a result, today there are a growing number of organizations recruiting franchise brokers and franchise consultants to fill this need⁴.

In July 2006, FranchiseInc! decided to enter the market creating our own franchise consulting division focused on establishing an international Franchise Consultant Network to meet this need.

One concern among franchisors is, "will this rush to create franchise brokers; in fact yield highly trained professionals?" I know FranchiseInc! is committed to an initial training and ongoing mentoring programs to ensure our consultants are among the most qualified. This need for above average industry knowledge is even more necessary in light of the MCOC. Sophisticated investors require skilled professionals to assist them in the finding of the right concepts for the placement of their working capital.

We implemented the MCOC early in 2007 and here is the profile of two of our existing clients:

1. Sales Executive/Consultant: Net worth in excess of \$4 Million - liquid for in excess of \$750,000.
2. Former High Ranking Government Official: Net worth in excess of \$2 Million - liquid for in excess of \$500,000.

These clients were already seeking franchise relationships as Area Developers and franchisees but were not happy with the risks associated with having their investments so vertical in one concept combined with the limitations imposed by territorial development criteria – More Later.

Fast Food and other similar brick and mortar concepts have dominated the industry. However, we are finding a new group of buyers seeking "minimum capital in" per concept, diversification, and high cash-on-cash returns are looking to service-based franchise concepts. The logistics of the brick and mortar franchise concepts do not lend themselves as well to this strategy. As consumers become more mobile with their shopping habits and density of the retail space continues to "market grab", franchisees

are increasingly at risk for the customer base moving away, while they remain stuck in long-term leases.

Service franchises, including short-term leases, likely provide a fertile ground for solving this new investment demand.

¹ERSOP see www.frantrends.com Article on: Franchise Funding Options

²http://www.fradata.com/presentations/20071010_Edith_presentation.pdf

³80/20 Rule: That 20% of any organization will do 80% of the production and 80% will produce 20% of the production.

⁴Brokers see www.frantrends.com Article on: Franchise Brokers and Consultants

About The Multi-Concept Operating Company (MCOC)

Background

Historically franchisors have offered serious investors opportunities as Multi-Unit Owners, Area or Regional Developer Agreements, Master Franchisee or Sub-Franchisor Agreements. The strength of these offers provided territorial control, but the weakness is: “so goes the franchisor so goes your investment”. This lack of diversity has given rise to a new breed of investor seeking a Multi-Concept Ownership strategy with lower initial investment per strategy and diversification in concepts.

Approaches

The Simple MCOC. This approach chooses from 2 to 5 concepts (most popular is 3) operating only one unit of each concept. Typically in the form of a limited liability company (LLC) holding the franchise of each concept. Almost always a single investor acting as president/CEO with Concept Managers (CM) as LLC employees providing daily operations of each concept – meaning the franchisor will have to approve this form of layered ownership/operation in lieu of the more common owner/operator format. The average investment per unit is from \$25,000 to \$100,000 (all in) with an additional 30 to 100% overhead support at the LLC level. Each CM falls under the direct supervision of the president. This can be likened to development of chain stores where there is a common owner and local store managers.

The Complex MCOC. Similar to the Simple MCOC, the differences being that some MCOC owners may choose to operate more or less concepts and have some concepts operate multi-units. Both Simple MCOC and Complex MCOC anticipate a minimum investment of \$250,000 to start with a typical funding in the \$500,000 range.

Overcoming Industry Risk

Of greatest concern to MCOC owners is how well staffed and managed is the franchisor. We have identified several investor networks where easily 100+ MCOC owners would accept our recommendation for a minimum of 3 to 5 concepts to be placed in their MCOC. The foreseeable risk is that many franchisors are only staffed to growing by one or two franchise units a month and could quickly have growth problems if 100 MCOC owners in a period of say 12 months acquired their units for placement in their MCOC strategy.

At the completion of this White Paper Update, FranchiseInc! has one franchise concept that is being used in MCOC strategies that we have sold over 100 units (in the last six months), another franchise concept that we are selling 3-5 units per month and several concepts having frequent MCOC unit sales.

The advantage of MCOC common buying is quick establishment of a national brand presence. Provided selected franchisors rise to meet the demands of the MCOC owners, they could quickly in 12 to 24 months find themselves rising from a small relatively unknown franchisor (likely only regionally) to a national brand ranked in the Entrepreneur's Franchise 500® or similar rankings.

A Strategy For Preferred Franchisors

Concerned with the possible implosion of certain franchisors from the rapid deployment of so many franchise units, FranchiseInc! has formed an open joint venture with a number of nationally recognized franchise experts covering every discipline in franchise growth. Our team members on recent projects have helped new franchisors achieve more than 200 units sold in 12 months and with our combined staffs we have over 50 employees that can be matrixed into a franchisor's home office team to ensure the MCOC investor that such rapid growth will not hurt the business model.

These services are made available through certain consulting agreements on a pay-for-performance basis to help franchisors with early cash flow concerns. These "Preferred Companies" are managed jointly with the existing franchisor home office team and a designated matrix team from our staffs. This provides MCOC

owners an added higher level of confidence in purchasing relatively new or smaller franchisors into their business model.

Franchisors which demonstrate the ability to manage the rapid growth are given priority in the selection process. All franchisors interested in the MCOC strategy should contact FranchiseInc!

MCOOC Owner Rational

No Guarantees – This Is A Business

While there are no guarantees in business, accredited investors are encouraged to evaluate if the potential cash flow and diversification of concept risk meets their objectives as a potential franchise owner. Franchising has historically been recognized as a safer choice than new business start-up. Widely quoted statistics indicate that about 80 to 90% of all franchises are still in business after the first 5 years as compared to about 20 - 40% for new start-ups. Franchises require individual attention and the MCOOC strategy is no exception. While the MCOOC proposes that the individual operating units will be managed on a daily basis by the Concept Managers, the MCOOC owner, acting as president, will need to oversee these managers to ensure budgets, sales and compliance requirements are maintained.

A Hypothetical MCOOC Model

Most franchisors do not make financial or income projections and we believe this is an appropriate response to the business environment. This MCOOC Model does not represent any specific franchise concept; rather it is a discussion of target parameters an owner might choose when developing an MCOOC.

Assumptions.

- ❑ The owner is an accredited investor familiar with investment and business risks.
- ❑ The MCOOC investment does not represent a significant portion of the owner’s investment portfolio or net worth. For example, an MCOOC owner with a \$2 Million net worth might only consider 10 - 25% of this net worth suitable for the risk of developing their MCOOC strategy and that failure of their business concept resulting in a total loss of these

funds is an acceptable business risk not resulting in undo risk to the owner.

- That the MCOC owner will not be a passive investor but will actively participate as president of the MCOC as an “at risk” investor seeking business income and not relying on the efforts of third-parties – meaning this is a business and not a security like a mutual fund.
- That all purchases of franchise units will be in full compliance with state and federal laws associated with franchise operations.

A Prototype Franchise Concept. One strategy would be to seek a franchise concept that may fit the following profile:

- Cost of franchise (all in) would be no more that \$100,000 and likely no less than \$25,000.
- Cost of Goods would be 50% or less.
- Recovery of initial investment would be 1-7 years with a goal of less than 3 years.
- The return on capital at risk would be 20 – 40% of gross margin with a target of 25%+ consistent with the 25-50-25 Rule.
- Operations costs, not including employees, would approximate 50% of annual gross margin consistent with the 25-50-25 Rule.
- The cost of employees including the Concept Manger would be about 25% of gross margin before bonus consistent with the 25-50-25 Rule.
- That the franchise agreement would allow for MCOC absentee ownership managed by Concept Managers who are employees of the MCOC.
- That the franchise agreement would enable a transfer sale from the MCOC owner to the Concept Manager without transfer fee.
- The franchise concept would likely be a service franchise requiring no brick and mortar or a short term lease concept.

Inquirers Welcome

For Franchisors. We are looking for franchisors who wish to be qualified as either Preferred Franchisors and are willing to work with MCOC owners to rapidly grow their business. Franchisors will be required to enter into certain consulting agreements which are custom-fit to your business model.

For Franchisees. If you believe you can qualify to become an MCOC president and run a diversified company managing multiple business concepts through a well trained Concept Manager team, you are encourage to give us a call and discuss this matter in strict confidentiality.

Thoughts & Conclusions

The MCOC is not theory, we have active owners and franchisors participating in these well thought-out business strategies. If you believe you have the vision to develop such concepts as a franchisor or franchisee, we welcome a confidential dialog exchange.

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This document does not contemplate the sales of any particular franchise or business opportunity but is a discussion of one strategy in the franchise industry. Not all franchise concepts will work with this strategy, due diligence is required.

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