

## Restaurant Research Think Piece – February 2011

### Private Equity Firms, Corporate Management and Franchisees: A Cultural Stew

- We asked Pacific Management Consulting Group to add further insight into the cultural impact of private equity acquisitions in the restaurant space as a follow-up to last week's article by Trinity Capital about current return benchmarks for private equity investments in the restaurant space. Please see Pacific Management's comments below:
- Private equity firms, chain restaurant company management and involved franchisees have complex, mutually dependent relationships, and differences in business focus and economics that make for a complex cultural stew. All three groups must be engaged and work together for brand success, which is hard won.
- The private equity firm promotes operational improvement; and synergies via a "buy to sell" mentality to get their investment back and realize a trading profit. With a 4 to 7 year term focus, they utilize both operational value creation and leverage and financial engineering. **The balance depends on the PE firm's own expertise and focus. PE firm ownership doesn't guarantee success, however.**
- More conservative and risk adverse while publicly held, company management post purchase is relieved to be rid of the day to day sales comps pressure and perhaps that of impending refinancing hurdles. It now has the opportunity to think more broadly. But it typically must adjust to faster reaction mode, more frequent and vibrant oversight by the PE Board, and often higher debt service. Management stands to benefit from the PE ownership philosophy.
- Franchisees are initially hopeful at ownership change but generally in the dark otherwise on the potential risks and rewards of PE firm ownership. They are not part of the deal team and get no vote. Their culture remains individually focused, with margin, debt, and unit development concerns foremost. Their outlook is the longest term of all, the length of the franchise agreement. And they often have the vast majority of the invested capital. And they do almost 100% of the customer execution. Many have personal debt guarantees, thus view matters personally, but also stand to gain size efficiencies as they grow. Franchisees can benefit greatly if the brand's chemistry, plan and execution comes together.
- About the contributing firm: Pacific Management Consulting Group is an analytically focused management consultancy, 100% focused on restaurants. The firm performs detailed sales, profitability, earnings and related economics projects work, and works for those who need deep business intelligence about the restaurant sector. The firm provides publicly traded chain restaurant financial and earnings analysis for investors, franchisees, other management consulting and earnings research firms; litigation support and new business startup planning. The firm passionately avoids conflicts of interest, to provide independent, creative and detailed perspective.
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