# Chapter 5 - Tailoring your valuation approach: Franchise focus

## Speakers

**Russell Prior**
Managing Director and Regional Head of Family Governance, Family Office Advisory & Philanthropy, for HSBC Private Banking in EMEA
**Andra Ilie**
Senior Adviser, Family Governance, Family Office Advisory & Philanthropy, for HSBC Private Banking in EMEA
**Gillian Morris**
Head of Franchising, HSBC UK

## Transcript

**Russell:**
So far, our experts have explored the specifics of valuations for real estate and technology firms. And now, we focus on franchising. We're joined by Gillian Morris, the Head of Franchising at HSBC UK. So, what makes valuing a franchise business different from another industry?

**Gillian:**
Well, franchising valuations differ from other business models because the business has a defined operating model, which makes it more replicable and easier to sell. Most mature franchise brands have an established secondary resale market already, and often the franchisor will have a target list of potential acquirers already lined up. That said, unlike a standalone business, the franchisee cannot sell their business without the approval of the franchisor. So the sale process has an additional step, and if the pool of potential buyers is limited, then that could restrict the maximum value achieved for the business.

**Russell:**
So like the other industries we've looked at, there are various factors to consider. But unlike the technology industry, for example, franchises have a more replicable business model. We asked Gillian whether there are any particular business metrics that are used in the valuation model for a franchise.

**Gillian:**
As a general rule, franchise cash flows in B2C businesses are more highly valued. They're generally recognised as being underpinned by behavioural consumer trends linked to the strength of the brand, therefore thought to be recurrent and stable, ultimately leading to a higher valuation. Even within franchising though, the sector will guide the type of valuation methodology that's applied, and this can vary from a multiple of weekly sales, to a multiple of the business EBITDA*. As a general rule, the more complex a business is, the more likely it is to be valued by an EBITDA model rather than weekly sales, and more simpler business models tend to be valued on a weekly sales basis.

**Russell:**
It's good to understand the two main valuation methodologies. Within that, we're also keen to understand which is the most important, the value of the brand or the value of the individual franchise?

*EBITDA: earnings before interest, taxes, depreciation, and amortization.

**Gillian:**
Within a franchise, there are two different values, the value of the brand and the value of the individual franchise. A good brand can underperform in the hands of the wrong franchisee, but it can still have an inherent positive value because of the brand and the footfall or customer recognition that it commands. This can also be an adverse factor as if the brand perception changes, then this can negatively impact the franchise value. Fundamentally, the reputation of the franchise brand in the marketplace is imperative to a sustainable business model. Any factor which has a significant impact on the reputation of the brand will affect the resale market and valuation.

**Andra:**
Is there a benefit for thinking about multiple outlets of a franchise?

**Gillian:**
As a general rule, having a single unit or a franchise outlet can cap potential growth. Therefore, growing organically or by acquiring neighbouring territories can really accelerate a franchise potential. This enables the franchise to leverage the economies of scale and the spans of control. Aspiring franchisees should understand the franchisor's growth ambition in their market and evaluate if the region or the territory can support the scale required without dismantling the underlying economics.

**Andra:**
Some interesting insights from Gillian. Franchise growth potential is definitely an important factor for aspiring franchisees to consider. But what other things should they focus on? What other factors can affect the valuation of a franchise owner's business?

**Gillian:**
A franchisee's main focus is their operational excellence. The key areas are those covering operational standards, customer satisfaction, and brand performance indicators. These will form an important assessment on valuations of the business and often where they're neglected, the sales valuation will be paired back during the negotiation to reflect negative trends or time and cost of repairing. A buyer will also seek reassurance that the franchisee exit will not be detrimental to the business and that key personnel and management will remain in place.

**Russell:**
Several factors can impact the value of a franchise, including the strength of the franchisee's brand, operational efficiency, and the franchisee's potential for expansion and growth into new markets. And they all collectively contribute to the overall valuation of a franchise business impacting its attractiveness to potential buyers or investors.

You can watch the other chapters in this episode on 'How to Value your Business', by visiting our **'Beyond Business Ownership'** series page.