

Global Expansion



Pricing an International Market

Michael H. Seid - Managing Director

It's a safe bet



"Southeast Asian countries are currently the "hot" markets"

Mitchell Speiser - Lehman Brothers - 1997

The Drivers



"Many companies are experiencing reduced or slower increases in unit sales when measured on a same store basis. "There are so many locations out there that every new one has to be stealing from each other's market. It's a real problem."

Sandra Shaber - WEFA Group

The Drivers



"Enticed by the lure of increased profits, many American restaurants are expanding beyond the U.S. Border, despite the obvious risks. Their stronger focus remains on the benefits of international expansion: huge growth opportunities, tremendous financial infusion, and worldwide exposure."

Kimberly Lowe - Restaurants & Institutions Magazine

Trends

- “70% of total system openings for McDonalds will be outside the United States” - Franchise Finance Corporation of America
- “Operating margins at McDonald's for international restaurants was 19.8% during 1996 versus 16.5% for its US locations” - Chain restaurant industry - FFCA
- “60% of McDonald's sales and profit come from international units” - Kimberly Lowe - Restaurants & Institutions

Trends

- “Sales - in units and volume growing faster internationally for top 100 companies” - Dennis Lombardi - Technomics
- “Profitability achieved more quickly franchised locations over company owned” - NRA
- “The emergence of the middle class is phenomenal. Even in third world countries, billions of dollars are pouring in” - Richard Snead - T.G.I. Friday

Real Life

- Many companies too immature to make international offering
 - Domestic operations are not sufficiently developed
 - Training insufficient
 - Sourcing weak
 - Research weak
 - Limited IT Capabilities

Real Life

- Organizational infrastructure immature
- Unable or unwilling to adapt product or service
- Insufficient capital for domestic operations
- Up Front fees required or used to support existing organization
- Market selection based on telephone ringing
- Many companies do not select franchisees who can provide missing elements

Real Life



- Litigation - increasing
- Anticipated return unrealized
- Brand devaluation in region
- Critical mass issues affecting ability to support
- Time to get license back elongated
- Modified domestic agreements often not adequate
- Inadequate professional advisors - foreign and domestic

Case Study

- Major Burger Chain - one
 - Franchisee living in the United States
 - Ill prepared local management
 - Real estate selection - type and number
 - Inadequate architectural planning
 - No source for buns or fries
 - High cost of imported beef
 - Unavailable burger press
 - Improper advertising and marketing
 - Litigation

Case Study

- Major Burger Chain - two
 - No significant international experience - franchisor
 - Master franchisee relationship - no franchisor training provided
 - Insufficient revenue stream - unanticipated support costs
 - Inexperienced franchisee - standards contrary to US brand
 - Modified domestic agreement inadequate
 - Franchisor unable to effect change
 - Franchisee unwilling to provide sufficient capital
 - No local sourcing - all products imported from US
 - Inability to modify product
 - Litigation

Brand Consistency



- The market is different - maybe
- Brand and concept consistency
 - service levels
 - quality levels
 - core offering
- Ability to support adaptation
- Effect on other franchisees

Determine Markets



- Proximity to existing operations
 - Ability to support - leveraging
 - Training capabilities
 - Technology - product transference
- Regional strategy
- Strategically planned

Determine Markets

- Consumer information
- Local and imported competition
 - growing in major cities
 - secondary markets being developed
- Market size
- Requirements for critical mass

Case Study

- Major Optical Retailer
 - Non-franchisor domestically
 - Inexperienced in international trade
- Determining Market Size
 - Insufficient base for competitive review
 - Lack of credible demographics for industry purpose
- Solution
 - Analysis of domestic consumer drivers
 - Literacy rate = eyewear purchase and replacement

Valuing the Brand

- Determine the relationship you can support
 - Company owned
 - Direct Franchising
 - Joint Ventures
 - Master Franchise Agreements
 - Area Development Agreements

Valuing the Brand



- Valuation changes
 - Introducing category
 - Introducing brand

Valuing - The Market

- Understand market opportunity
- Consumer preferences
- Consumer availability
- Location availability
- Local competition
- Political and economic climate
- Local regulations

Valuing - The Market

- Labor - cost and available
- Availability of ingredient and other requirements
- Marketing strategies available
- Language and culture
- Legal structure of country
- Trademark protection
- Critical mass requirements

Valuation - Costs

- Understand your cost structure
 - Travel and living expenses
 - Telephone and fax
 - Local market research
 - Modification of product and service
 - Registration of products locally
 - Product and equipment sourcing
 - Export options

Valuation - Costs

- Understand your cost structure
 - Adaptation of marketing materials
 - Site selection assistance capabilities
 - Build out variations
 - Equipment adaptation
 - Local sourcing
 - Ongoing operational support
 - Legal expense

Valuation - Revenue

- Understand revenue opportunities
 - Understanding costs gets you to break even - maybe
 - Establish investment hurdles
 - Development requirements
 - timing
 - ownership
 - projected unit sales

Setting the Fees

- Only partially an art
- Market fee
 - opportunity costs
 - covers up front costs
 - ensures commitment by franchisee
 - depends on the strength of the brand
 - depends on the competition
 - subject to negotiation

Setting the Fees

- Term
 - Test Periods
 - Ten to Thirty Years
 - Renewal
- Development Schedule
 - Company owned
 - Initial period
 - Extended period

Setting the Fees



- Initial Fee
 - Market fee
 - Unit fees
 - Present value of cash stream

Setting the Fees

- Royalties
 - Same rationale as in U.S.
 - Should compensate for support
 - Should provide for return
 - Usually on gross sales but may be fixed
 - Often sliding scale to encourage development
 - Exclusions for local taxes (vat, excise, sales)
 - Exclusions for low gross profit sales

Setting the Fees

- Product Sales
 - Competitive with local sourcing
 - Cost of distribution
 - Quality diminution
- Local Market Support
 - Staff living expense including family allowance
 - May include salary, tuition for children

Setting the Fees

- Initial Training
 - Usually included for defined number of staff
 - Fee based for additional staff
 - Fee based for providing training staff in country
 - Mandatory training provisions
 - Mandatory attendance at supplemental training or conferences

Setting the Fees

- Taxes
 - Withholding at source - net royalty method
 - Local income taxes
 - May provide for franchisee
 - Reimbursement for taxes in excess of maximum allowable US credit
 - Paying all or part of non-resident withholding taxes
 - Remittance taxes, remittance discounts, stamp tax, exchange tax, exchange discounts, registration fees

Setting the Fees

- Overall fee structure and relationship is set based on net funds remitted to United States
 - Requires sophisticated tax planning for the US and Foreign market
- Allow for local viability
 - Franchisor and franchisee

What This Means

- International expansion is not a short term solution to problems
- Long term strategy
 - Requires senior management commitment
 - Can be resource drain unless prepared
 - Measure against domestic options
 - Requires planning
 - Requires sophisticated tax planning

What This Means



Be realistic

Regardless of your time and
financial plan - it will take
longer and cost more

Michael H. Seid

Michael H. Seid & Associates (MSA)

94 Mohegan Drive

West Hartford, CT 06117

(860) 523-4257

(860) 523-4530 – Facsimile

mseid@msaworldwide.com

www.msaworldwide.com