Intellectual Property Securitization and Growth Capital in Retail Franchising

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Abstract

A retail franchisor needs growth capital so that the brand continues to grow and franchisor–franchisee relations remain strong. However, access to corporate liquidity to fund such franchise growth options is not unlimited. A method of raising finance particularly suited to retail franchisors is intellectual property (IP) securitization that allows companies to account for intangible assets such as intellectual property, royalty and brands and realize their full value. In recent years, a number of large restaurant franchisors have securitized their brands to raise funds, including Dunkin Brands and Domino’s Pizza (Domino’s). We use property rights approach to show that IP securitization provides mechanisms that explicitly define ownership of intangible assets within the securitization structure and thus enables a company to raise funds against these assets. Using a case study example of a retail franchise IP securitization transaction, we also provide evidence that these mechanisms are not overly restrictive and can be used more widely to help fund retail franchise growth and expansion.

Keywords: Retail franchising; Intellectual property securitization; Brands; Franchise growth

Introduction

Retail franchise growth is a critical parameter in a franchisor’s network stability. A franchisor may support its ambitions for rapid growth by improving its brand’s appeal as well as helping develop its franchised units. The low contractibility of the financial assets in the early phases of a franchise’ organizational life cycle points toward this critical role of a franchisor in assisting its franchisees (Windsperger and Dant 2006). Franchisees of retail brands also need to provide an assurance that they are a stable business. This is important as many entrepreneurs embark on a franchising business because it offers the greatest potential financial rewards (Bradach 1998; Grünhagen and Dorsch 2003). Anyone looking to start their own business and capitalize on the opportunity offered by a franchise brand will be concerned with the long-term strength and viability of the franchise they are taking on. It is for these reasons that franchisors pay close attention to their own capital structure, in the manner they raise funds, in addition to their relationships with their franchisees.

The strength of a franchise business is also tested during a time when credit conditions are fragile. Due to large liquid-
in good measure the practice of IP securitization, and that it is a valid means of raising finance, especially when companies derive their significant value from intangible assets.

The article is divided into four sections. The first section discusses general issues involved in retail franchise growth, in particular the role of a franchisor as a capital provider. It is followed by our introduction to the IP securitization method. We then provide a case study of Domino’s securitization, including an early assessment of its performance. The final section concludes with suggestions for future work in this area.

**Retail franchise growth**

Watson et al. (2005) suggest that a particular feature of retail organizations is asset intangibility, and therefore they use franchising to be a valuable means by which to develop their businesses, both domestically and abroad. Their empirical findings provide ample proof of the positive impact of franchising on the intellectual capital development and knowledge management for retail organizations. Franchisees typically are the engine of growth at many retail chains, in particular restaurants (Bradach 1998). Franchisees help develop retail markets by breaking into new territories and opening new units. Franchisees may also be instrumental in purchasing the franchisors’ underperforming stores earmarked for improvement. However, franchisees may need financial and transactional help when looking to open new stores or purchase underperforming stores (Grünhagen and Dorsch 2003; Kaufmann and Stanworth 1995). The re-purchase of underperforming units can be part of a franchisor’s strategy to turn around domestic results. This requires that the franchisors have sufficient resources available to finance and support such transactions. This is also the view of Norton (1995, 1998) who argues that franchising exists in order to reduce “operating and financial transactions costs.” This is against the capital constraint or the resource dependence hypothesis that suggests franchising provides capital for the franchisor at lower costs (Caves and Murphy 1976; Ozanne and Hunt 1971).

Norton’s view can be verified by casual evidence from the restaurant franchising industry. Restaurant franchisors implement specific programs that broaden their franchise bases as a means to grow business. In addition to implementing measures that grow same-store sales, they may also emphasize franchise recruitment as a way to expand their franchise operations. For example, in recruiting new franchise demographics, franchisors as diverse as Pizza Hut, KFC, Domino’s and Little Caesars Pizza have introduced special recruitment incentive programs for veterans, minorities and women. Domino’s offers veterans a $20,000 discount off the franchise fee. These programs are underpinned by the need for offering greater financial security and lower risk to the prospective franchisees. The programs may also translate into helping franchisees get financing, as well as more favorable lease and real estate terms. They thus provide an additional layer of support, over and above the backing a franchisor can offer to its franchisees with a well-known brand and assistance and network cooperation (Bradach 1998; Lafontaine and Shaw 1999). There is also an opportunity to demonstrate that the franchisor’s capital base is solid and can cope with any
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