

## Building a Critical Mass

Large deals with established minority business enterprises can provide an easy—and profitable—path to operator diversity. [By Pam George](#)



Like most businesses in the U.S. hospitality industry, Spirit Cruises experienced the fallout from September 11, 2001. A pioneer in the dinner cruise segment, Spirit has ships in major cities, including New York City and Washington, D.C.

The company had firmly regained its footing by 2005. However, its parent company, Sodexho USA, no longer considered dinner cruises part of its long-term strategy. An arm of French-based Sodexho Alliance, Sodexho's core offerings focus on food- and facilities-management services.

"We were kind of an odd fit," says Lorna Donatone, president of Spirit Cruises, which was founded in 1978. "We said, 'Let's go out and see what the market is. We have a lot to offer.'"

Apparently, ICV Capital Partners agreed. The New York private investment firm in 2006 had acquired Spirit's competitors, Premier Yachts and Seadog Ventures.

Spirit, a \$55 million business, was a natural addition, and in August 2006, ICV's newly created company, Entertainment Cruises Inc., closed the transaction with Sodexho.

With locations in six markets, including New York, Philadelphia, Chicago, and Boston, Entertainment Cruises now possesses a healthy 25-percent market share, with annual revenues of about \$85 million.

But that is not what is so groundbreaking about the deal. The transaction represents a changing tide in the foodservice industry. ICV Capital Partners is a minority-owned firm, and with one fell swoop, the deal effectively boosted diversity in a food-industry sector.

ICV, which has more than \$440 million in committed capital from institutional investors, is becoming a major player in the hospitality and entertainment industry. In 2006, ICV's sister fund, American Securities Capital Partners, provided growth capital to Potbelly Sandwich Works. In 1999, ASCP acquired El Pollo Loco.

Meanwhile, ICV in 2003 invested in Chung's Foods, which provides Asian appetizers and entrees and in 2001 invested in Sterling Foods, a leader in bakery products.

The firm plans on making additional investments in the food industry that could include large transactions in the quick-serve market.

“The quick-service world is growing,” says Tarrus Richardson, managing director of ICV. “They need to have larger franchises in their network, and the same is true on the supplier side.”

And when those large deals include a minority business enterprise, MBE for short, quick-service restaurants can improve their diversity initiatives.

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“A few large transactions in the marketplace will definitely enhance the diversity of the portfolio of any franchisor,” says Valerie Daniels-Carter, CEO of Milwaukee-based V & J Holding Co., which owns 39 Burger Kings, 72 Pizza Huts, and one Wing Streak.

“We need franchisors to step up to the table and make the commitment to do large transactions to help us get at parity in the marketplace,” she says.

And such deals don’t have to be limited to franchisees. They may include suppliers and, as was the case with Spirit, minority-owned investment firms. New York-based Palladium Equity Partners, a private-equity firm founded in 1997 by Marcos A. Rodriguez, in 2005 acquired TB Corporation, parent of the Taco Bueno restaurant.

But it takes the ideal combination to make a successful transaction. While chains are interested in increasing diversity, they won’t sacrifice quality, service, and price, says Charles “Chuck” James III, CEO of C.H. James Restaurant Holdings in Chicago, which owns 43 Burger Kings. “That remains the problem: how to connect the players.”

Financing remains critical. Yet for the MBE with the right experience, there is capital available, says Kevin Jordan, managing director of Goldman Sachs Urban Investment Group, which provides growth capital backing for minority entrepreneurs. The company makes investments ranging from \$5 million to \$50 million, with the higher end of the scale being preferable.

## An Evolution

Doing business with an MBE in a big way was an anomaly when Daniels-Carter and her brother, John Daniels Jr., opened their first Burger King franchise in 1984.

“We were a small operator for a number of years,” Daniels-Carter says. “When we got to seven restaurants, that’s when we started multi-unit acquisitions. Our largest was the 61-unit acquisition with Pizza Hut in 1997.”

Former Milwaukee Buck Ulysses “Junior” Bridgeman also followed the traditional path. “You have to go back 20 years,” says Bridgeman, whose company, Bridgeman Foods in Louisville, Kentucky, owns 160 Wendy’s franchises and 25 Chili’s.

“Times were different then,” he says. “We started as a franchise with one store, then bought five then built some ... it went that way for a number of years.”

Now franchisors increasingly want a greater return on their agreements. Jordan understands the appeal. “As we say in our business, it takes just as much work to do a small deal as a large deal. So why not do a large deal?”

Large franchisees and vendors offer an appealing economy of scale. James, for instance, can amortize the cost of hiring a community-relations representative over his 43 stores. The same is true for insurance and other operational costs, he says.

Moreover, a large franchisee company can prove less vulnerable to the shifting marketplace. A one-unit franchisee with an underperforming store could struggle and fail. But a multi-unit operator could offset those losses with better-performing restaurants.

There are also pluses on the supply end. In an economy in which there is pressure to keep costs down, a firm capable of mass distribution offers improved savings. “If you’re trying to supply a quick-serve, you’ve got to have national distribution and the ability to get all your products at the same quality level throughout the network,” Richardson says.

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The advantage of doing business with a large company is multiplied when a MBE is involved, particularly when it comes to reaching the nontraditional customer, such as Hispanics and other minorities.

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“It’s always good for franchisors to have franchisees that look like their customer base,” James says. “Franchisors don’t want to be perceived as an extractor of wealth from a community.”

Business owners from the target market can often provide the best market insight, Richardson adds. “It enables people to have stronger, deeper, and more long-term ties within those communities, which should lead to more profits, more revenue, and more wealth within the neighborhood in which they’re doing business.”

Deals with large MBEs also advance diversity initiatives. “You can really make a game-changing move overnight by signing up the right person with the right capital structure with the right management team,” James says.

## The Right Stuff

Certainly, timing and talent came together in 2004 for James, who partnered with the Goldman Sachs Urban Investment Group to purchase 37 Burger Kings in Chicago.

James’s food-industry experience helped seal the deal, Jordan says. “Chuck was able to come into our office and show us that he was somebody we want to back, who we think will be successful.”

The fourth generation to own and run his family’s wholesale food-distribution business, James’s experience includes an e-commerce business, ProduceOnline, which in 2000 merged with World Commerce Online. He is also the former chairman of the board and CEO of Dallas-based PrimeSource Foodservice Equipment, Inc.

When he decided to venture into the quick-service restaurant arena, he approached Goldman Sachs. “I said, ‘I’ve got the experience. I’ve got the relationships. I know the industry. I have some capital, but if we can combine my capital with your capital, we could do a much larger deal that would make sense for everybody,’” James says. “And that’s what we did.”

Financial backing has become imperative for entrepreneurs who want to go from zero to 37 or more stores in one deal. It is also key for franchisees looking to expand.

In 2006, Bridgeman Foods received funding from Scottsdale-based GE Capital Solutions, Franchise Finance to triple its size within the Chili's franchise system. The company finalized a \$27 million deal with the GE division in 2004 to refinance existing debt and improve cash flow for future construction.

There are other reasons to partnering with an investment firm. For one, it increases the likelihood of a successful outcome, Jordan says. Firms rarely handle transactions that might fail.

Investment firms also have a wealth of resources, including savvy lawyers and the staff to handle due diligence.

"We are more efficient to deal with, and we're also dealing with larger dollars," Jordan says. "More can be accomplished with the same amount of effort." As a result, sellers are more likely to look favorably on the deal, he says.

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For proof, consider ICV Capital's purchase of Spirit. Once the firm purchased Premier Yachts, it had the experience—founder and CEO Michael Higgins stayed—and the capital to make it a credible buyer.

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"Over the course of 12 months, we invested either through us or our affiliates about \$50 million in equity to create this opportunity," Richardson says of preparing Entertainment Cruises for the Spirit purchase.

While solid financial backing helps, large deals with MBEs can hinge on the other party's eagerness to do business.

Sodexo, for instance, has an established track record when it comes to business transactions with minority-owned firms, says Jaya Bohlmann, vice president of public relations for Sodexo.

"We are a global company, and it's always been inherent in our culture," she says. "We believe it makes us more in tune with what our clients want and that it makes us more competitive."

Last summer, Sodexo partnered with Magic Johnson to form Sodexo Magic, which seeks meal-service contracts for sports arenas, universities, and other venues. (Johnson also owns Starbucks and Burger King stores.)

For the Spirit deal, Sodexo received a diverse list of potential buyers from its advisor, Spirit Cruises' Donatone says.

Richardson would like other companies to take a similar approach. "Every time a property between \$20 million and \$500 million in revenue comes up for sale, the seller should have a diverse list of potential buyers, so we can get more businesses into minority hands."

## Shifting the Mindset

So why aren't there more multi-million dollar deals with minority-owned companies?

Certainly there are qualified entrepreneurs, people of color with college degrees and managerial expertise who are ready to strike out on their own, James says. There are also companies like McDonald's and Burger King with aggressive diversity initiatives. The funds are available, thanks to companies like Goldman Sachs and ICV Capital.

But making the connection is still a hurdle. “For us as investors, our deals are only as good as the ones we seek,” Jordan says. “Our biggest challenge is finding opportunities. Once we find them, getting them done is really not a problem.”

Size can also be an issue. A five- or 10-store franchise deal is too small for Goldman Sachs, he says. Once the number creeps beyond 20, factors also include the sales potential.

Likewise, MBEs must think big. Historically, many minority businesses have been small, James says. “But if you’re going to be a supplier to a major franchise, it doesn’t work to be a small business person.”

Getting the word about deals like ICV Capital’s purchase of Spirit helps raise awareness, Richardson says. “It just takes conversation, exposure and, quite frankly, some resolve.”

It also takes recognition.

“We are business people,” James says. “This is a \$50 million organization. I have 1,300 employees. I have a CFO. The minority piece is part of the angle, but the fact of the matter is that we are experienced entrepreneurs putting the capital together, looking at markets, finding demand, and doing things in a meaningful way.”