Managing Partnerships May Yet Prevail

Fourteen years ago, Texas Roadhouse Founder Kent Taylor stood on a stage at the Restaurant Finance & Development Conference in Las Vegas. Using slides, Taylor, then 51 years old, outlined how the chain grew from two restaurants in 1993 to 286, in 44 states, by 2007—three years after its IPO.

The first twelve slides, in fact, detailed how he and investors carved out their stakes in the first 25 restaurants. They also listed Taylor's five concept failures and his brief yet instructive tenure at Hooters and KFC. Taylor, who died last month, learned along the way that success wasn't merely conditioned on giving up significant ownership to raise capital but also on sharing capital with the people who ran your restaurants.

"Source great people and treat them right!" read slide 18, which detailed the company's managing and market partner programs. Treating them right included offering store managers the chance to earn 10% of the unit's operating income, according to the slide. True, managers had to come up with a $25,000 "deposit" and sign a five-year contract.

Nonetheless, recalls former Managing Partner Dan Burton, who ran a Texas Roadhouse in Cleveland in the early 2000s, "They gave you ownership. You did basically everything, from pest control to cutting grass. You knew that every dollar was yours. It was like watching your own finances."

Burton, now owner of a corporate catering company in Tampa, adds his base salary was then $45,000: "I knew guys making $65,000 and guys making $165,000."

Where does this compensation tool stand today? I recently solicited opinions of restaurant executives, investors and recruiters familiar with managing partnerships about their effectiveness. All agreed restaurants typically performed better when operators had skin in the game. "We have seen many that are outstanding, encourage the 'ownership' mentality, alignment and retention/cost savings," said a private equity investor who asked for anonymity.

"It's a great way to get close to owning [a restaurant]," offered executive recruiter Joe Talarico, a former vice president of operations for Buca Inc., which hired managing partners. Recalled former P.F. Chang's CEO Rick Federico: "If you asked fifteen management candidates where do you see yourself down the line, inevitably they would say, 'I want to own my own restaurant.'"

"One of the things that flies under radar with these programs is how many millionaires were made out of ordinary people," declared Bricktop Executive Vice President Brad Saltz.

Today, it's not really clear how popular managing partner programs remain. According to Black Box Workforce Intelligence, which tracks job titles among 137 brands, just 21 "use either managing partner, operating partner or restaurant partner to designate their general managers," Victor Fernandez, vice president, wrote in an email.

What's more interesting is "of the 21 brands, 12 belong to 3 companies that operate multiple restaurant chains within their systems," Fernandez added.

Torchy's Tacos, an 83-unit chain based in Austin, Tx., began using the title and requiring a capital investment a few years ago, according to CEO G.J. Hart, who declined to cite the amount. Hart, a former Texas Roadhouse CEO, disclosed in an email that managing partners are entitled to 7% of store-level operating profit, plus base pay.

A Torchy's unit reportedly rings up an average $3.8 million annually. Assuming operating profit is in the 15%-20% range (typical for Mexican food concepts that sell alcohol), managing partners could earn $50,000 (depending how "operating profit" is defined) on top of their reported $45,000 annual salary. "This program has created an ownership mentality in staffing, operations and business decisions," Hart wrote.

Torchy's Tacos is a full-service concept, the segment in which managing partnerships first arose. Outback Steakhouse, often credited as introducing the program to the space in the early 1990s, arranged it so that "at the end of five years each [managing partner] will have stock worth around $100,000," as co-founder Chris Sullivan wrote in Harvard Business Review in 2005.

"I'd still say even in today's dollars that figure over a three-year period is still a good one," said a former restaurant executive who has implemented managing partner programs at several brands.

Perhaps understandably, Sullivan's article doesn't mention fast-casual restaurants, which by 2005 were attracting millions of investment dollars. Investment banker Susan Miller of Morgan Kingston believes managing partner programs in restaurants with AUV of less than $2.0 million "as talent-retention driven, rather than as a source of capital for new unit development."

So why not use a franchise model instead to grow, she asks. "Today's unit count is the cheapest an emerging brand will ever be. If I am an owner, the less mouths I have to feed on the first exit or round of institutional capital, the better," she said.

Results Thru Strategy's James McGehee, who often works as an interim CFO, told me he's in favor of restaurants offering managing partnerships because an emotional attachment is often made between managers and communities. But he warned that financials have weakened in the past year. "It all starts with a return on investment capital model that has enough bandwidth where ownership can share — and quite honestly, most of them can't," he claimed, predicting that distributions could fall to 2%.

Then again, offering skin in the game to store managers early on may enhance the financial model. "You want to come out of the box early very strong," said the private equity investor, "and 'giving up' some economics to ensure that your concept is being well executed in its formative years could be a good investment."

—David Farkas