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What works

Franchisors helping franchisees means being part of the solution

By Dennis Monroe

Many of you know from reading this column over the years that I believe franchisors should play an active role in helping their franchisees. Franchisors historically seem to take three basic approaches:

Ignore the Problem: The first approach (which was common for many years) is for franchisors to ignore the situation and believe it is the franchisees' problem. This approach may have been plausible in the past when poor performance was due to franchisee operational inadequacies. However, today many franchisees are in trouble because of old and tired systems where the franchisor has not taken an active role in trying to reposition the franchise as well as the general overall economic decline.

No Prisoner Approach: The "no prisoner" approach is when the franchisor goes after franchisees with a vengeance when they are unable to meet their development obligations, cannot come up with the money for appropriate remodels, and are behind in their franchise royalty or advertising payments. This approach has been noticeable as reflected in the recent increase in litigation across many systems, particularly in QSR.

Proactive: The third approach is a proactive approach whereby the franchisor recognizes cooperation is the key to preserving a franchise system. While everyone has to do their part, in many cases some of the elements for the franchisees are truly outside their control and need to be looked at on a more global basis. And solutions must be found that fit both the franchisor and franchisee.

The most interesting thing I've seen is franchisors addressing the franchisee's inability to develop and fulfill their development obligations. A good share of the franchisors I work with have been proactive by going to the franchise community to either suspend development obligations for a period of one to two years or renegotiate development agreements to meet the needs of both the franchisee and franchisor. If the franchisees are able to develop, in many cases franchisors are providing incentives for this development. These incentives normally are in the way of royalty relief or a suspension of the royalties for a period of one to three years.

As I've written in the past, many franchisors are taking a very aggressive approach to providing dollars for development. Some of the approaches franchisors have taken are:

- Direct loans;
- Enhancements (meaning guaranties or a new marketing arrangement with lenders with funding for the franchise system);
- Credits (against the royalties);
- Providing financing planning tools (such as business plans and credit evaluations);
- Assisting in lease negotiations; and
- Becoming obligated on a secondary basis.

These franchisor efforts have all been a great help for franchisee development. As to troubled situations, there are three major issues causing stress in the franchise world.

Inadequate cash flow: In many cases, the lenders in today's market are willing to work with stressed franchisees by doing a restructure, lengthening amortizations, putting a portion of the debt on nonaccrual, or even forgiving a portion of the debt. However, lenders and even landlords, view the franchisor's participation as a key component of any type of workout plan. I have seen a number of franchisors who have participated in franchisees' workout by deferring royalties, forgiving past due royalties or even allowing the royalties to be paid under a waterfalls approach (where they will only be paid if there is an adequate cash flow after some minimum level of debt service).

Remodel obligations: Franchisor remodel obligations and/or the required purchase of new equipment can put a lot of stress on the franchisees. On the other hand, franchisors are caught between a rock and a hard place. They've seen their system's sales erode; and they realize that in order to re-establish their brands, significant capital improvements are probably necessary along with an image change and new equipment. This all may be true but unfortunately, many franchisors have become almost myopic and have told the franchisees that they have no choice but to comply with the capital improvements.

Sometimes franchisors have tried to implement these changes through operating procedures (which legally is somewhat suspect) or by enforcing general requirements under the franchise agreement. Remodels and improvements are important in the franchise world, but if franchisors insist on these steps, they need to provide financing for franchisees.

More importantly, franchisors have to show franchisees that there will be a return on these capital investments. It is important for the franchisor to show through the capital expenditures on their corporate stores the effect of these proposed changes. They need to put their money where their mouth is before they expect franchisees to make these changes. Unfortunately, some franchisors have forced this issue and begun litigation against franchisees.

Store Closures: I've seen a tremendous amount of issues lately with store closures. Many franchise systems are mature and have a number of units that should be closed. But franchisors, particularly if they are publicly traded, are under tremendous pressure to keep the number of franchise units at a constant level and actually show some type of unit growth. Closure of units does not seem to play into the franchisor's public relations with the investment world. This being said, the franchisors have to allow reasonable closures without a significant payment by the franchisee. The reason these stores need to be closed is that they are losing money. When a franchisor asks for some type of payment (or "liquidated damages"), the franchisor is taking a very short-sided approach. The franchisor should focus on working with the franchisee on relocation and not focus on collecting a closure fee.

Franchisors need to be part of the solution for a troubled system. Some other creative franchisor solutions are to buy back troubled units from the franchisee (thus protecting creditors, both secured and unsecured); enter into joint venture agreements, or provide capital for certain turnarounds. Franchisors have, at times, assisted franchisee credit issues for system-wide vendors and stood behind vendor payments until the franchisee can get back on its feet. A number of franchisors have provided operational support and helped negotiate rent reductions. Or found ways to enhance the franchisees' store level profitability.

I encourage every franchisor to take an enlightened approach to all aspects of the franchisee/franchisor relationship. This approach includes everything from development to royalty payments to store closures to remodels to capital expenditures. When the franchisor works together with its franchisees, most can all endure this continued economic slowdown. FT

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