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This column has recently addressed economic issues and how they affect the franchise industry. This month we'll finalize the series by discussing how the franchisor can help its franchisee community.

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Teamwork

Offering help without losing revenues

It seems that there are very few franchise systems that are immune from the economic downturn. In almost all areas of franchising, unit sales are down over what they were in 2006 and 2007.

While certain areas of the franchise world have experienced strong growth in terms of franchise applications (particularly the service industry where people are looking at these franchise opportunities to replace jobs lost in the non-franchise sector), most retail areas of franchising are very volatile.

One problem in addressing franchisee issues is that actions taken by franchisors usually result in some type of earnings reduction for the franchisor. In many cases, the solution is for the franchisor, in order to protect the franchisee community, to take a reduction in their royalty streams or upfront franchise fees.

Consider the following items which, in many ways, have less of an impact on the franchisor's P&L but have a great impact on the franchisee community.

1. Financial analytical assistance

Franchisees are often not skilled in analyzing their financial statements and understanding where or how they can improve operations and financial results. Further, franchisees are often reluctant to share any more financial information than is necessary because they fear the franchisor may interfere.

Consider this an option: A franchisor should take one of its best analysts or hire someone who is knowledgeable in the franchisor system. Send that person out into the field to meet with key franchisees. Also have that analyst sign a confidentiality agreement so he or she will not disclose to the franchisor franchisee information that is not already available to the franchisor under the Franchise Agreement. This financial assistance will greatly help the franchisees. These are the types of people franchisees always involve in trying to get operational assistance. The same type of approach should be taken concerning financial assistance. This does not mean the franchisor will provide economic help, but it does show that the franchisor is going to help the franchisees help themselves.

2. Marketing Assistance

A key element of a franchise system is the role of the franchisor in marketing. A necessary key element during an economic downturn is unit-level marketing, sometimes what is called guerilla marketing. I love what the Jimmy John's system has done. They have a global marketing department that goes out to help franchisees—both starting-up and mature franchises —in their marketing efforts. In today's world, mass media advertising is great but not the total solution. This type of focus on local store marketing requires resources, but generally does not require the huge dollar outlay that mass media advertising involves. These guerrilla marketing people should be available to franchisees and take an active role in working with the franchise community.

3. Workout Team

If the franchisor suspects certain franchisees are having financial problems (which are normally with their other creditors, they are overleveraged, have poor cash flow, etc.), the situation may necessitate a restructuring of the franchisee. There are a number of qualified professionals who have been through the cycle of franchisee workouts and can be made available by a franchisor to the franchisee community. In many cases the franchisor should help fund an initial valuation of the franchisee's business. This has been very effective in both the Yum! and Burger King systems to help financially troubled franchisees.

4. Staffing

"Good times" frequently mask over poor operations. Franchisors who have created bench strength of key operating people within their system can then draw on those operating people to go into the field or to become actual employees of key franchisees. This type of staffing assistance can often help turn around franchisees who are struggling. Franchisors can offer severance packages that allow that employee the incentive to work for a franchisee. Also, a franchisee can be encouraged to offer to a departing franchisor employee certain ownership incentives that probably would not be available at the franchisor level. This kind of pinch-hitting strength can be tapped into as one of the key elements for protecting a franchise system.

5. Flexibility as to Capital Improvements and Remodels

Franchisors are always concerned about remodels and capital expenditures to keep their systems current. Many times, this focus becomes intense during a business downturn because the franchisor feels that the system needs to be upgraded to attract new or returning customers and generate additional sales. A prudent franchisor should make sure that all required remodels and capital improvements generate a proper return. Further, franchisors that provide some form of financing for these types of improvements are going to be much more effective in getting franchisees to upgrade. Finally, there should be leniency during difficult times, such as postponement of required expenditures in recognition of the franchisees' downturn in performance and cash flow.

6. Development Schedule

This topic has been a focus in this column many times. Always remember that new unit development is very expensive. For a franchisor to enforce a tough development schedule during an economic downturn is a mistake. A franchisor should always be conscious of where developers are in terms of executing their development schedules. Rather than waiting for developers to come to the franchisor, the franchisor should take the initiative and tell its developers that it understand sthe economic downturns and that development needs to be curtailed or put on hold. The franchisor should take the initiate as to all aspects of development.

7. Purchasing and pricing assistance

Franchisors should make all reasonable efforts to leverage system-wide purchasing power. Faced with widespread increases in commodity and energy costs, franchisees are eager to find cost relief wherever possible. Franchisors can often provide great leverage in managing vendor relationships and limiting or reversing cost increases.

8. Attitude

Franchisors should create an attitude of cooperation during these tough economic times. Many times franchisees are embarrassed because they cannot make their royalty payments and are having tough times. The franchisor should look at each situation and try to be sympathetic rather than adversarial toward the franchise community. The franchisor should avoid stating that a particular franchisee is a poor performer or is over-leveraged while other operators in that region are doing well. Those types of negative statements do nothing to enhance the franchise community or help the franchisee get his or her business turned around.

In general, there is much that can be done by the franchisor in tough times that does not require a significant amount of capital outlay. The franchisor's efforts can greatly enhance the franchisees' efforts to help themselves and could be a way the franchise systems could be known as progressive, cooperative and understanding. FT

Thanks to Jim Wahl, co-chair of our Franchise Distribution and Intellectual Property practice group, for taking some of my rough ideas and making them understandable.