

Creative Strategies for Franchise Businesses to Navigate Challenging Economic Times
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Massive Wall Street bailouts and the mortgage crisis have left the U.S. economy reeling. No one is immune to the repercussions of an unstable economy, especially not franchise businesses. For franchisors and franchisees alike, these turbulent times call for a well-informed and reasoned strategy to help franchised businesses withstand the current state of the economy. The most important thing to remember is that these challenging economic times are temporary- the economy will eventually get better. It would seem that the easiest and quickest way for a franchisee to insure its financial survival is to lower quality and cut back on services. However, the better alternative may lie in franchisees seeking innovative temporary financing to survive the current, but temporary, state of economic affairs.

What innovative ways are you seeing franchisees use to acquire financing?

Look for angel investors (individuals that are looking to invest long term in start-up businesses) in unexpected places. Family members, friends and acquaintances are one potential source for funding. If you offer obtaining a loan with a higher interest rate than what can be currently obtained with treasury bills and certificates of deposit, you might have unexpected success. You may or may not be compelled to secure such a loan by granting a shareholder interest in the business in the event of a default. Alternatively, you could sell a minority interest in the business to a friend, family member, or acquaintance in exchange for realization on future profits.

Franchisees should also consider working together to help each other succeed—if all franchised locations of a particular brand are doing well, it provides an intangible goodwill benefit to all franchisees. Thus an already established franchisee may be interested in investing in someone else's franchised business both for the potential return, and the benefit to the brand. Franchisees will be even more likely to invest in other franchisees if that loan is secured by a shareholder interest in the business in the event of a default. A polished business plan setting forth the borrowing franchisee's prognosis of the business and how it plans to navigate this treacherous economic climate will help a franchisee's chances for financing in every event.

A truly innovative source of financing might be found in recently laid-off corporate executives. These individuals have lost their jobs, but still have money saved that they may wish to invest. The same could be said about investors who are taking their money out of the stock market and real estate investments and are looking for a different type of investment. If you offer them a better, and perhaps more secure and less volatile, rate of return on their money than the banks or Wall Street, they might be interested in hearing your plans for your business. These folks may also be enticed by offers of operational involvement and working for the franchised business.

What are the biggest challenges facing restaurant franchisees in this economy?

Maintaining extremely high levels of quality, service, and cleanliness are of the utmost importance, as these form the bedrock for a successful franchise business. Franchisees must take care during these tough times not to succumb to the temptation to lower quality and reduce

services. If a franchisee implements imprudent cost-cutting measures, the resulting negative fallout could very well cause long-term damage that lasts well beyond the current, but temporary, state of economic affairs. Customers will definitely notice when the product quality of their local franchised business takes a decided turn for the worse, and they will not forget a negative experience. Slighting customers during a tough economy means they won't be back when times are better. In fact, the most important time to step up your levels of quality, service and cleanliness for your franchise business is during an economic downturn, because you are competing for fewer dollars that are available in the marketplace. Customers are price conscious to some extent, but they have not forgotten the discriminating tastes that they developed during more robust times. If a franchise business wants to survive, it has to continue to live up to these high standards.

What is on the horizon?

There is no question that international franchising is taking off. There are potential opportunities for U.S. franchisees to partner with overseas corporations looking to start franchising in the American market. International franchises are constantly trying to break into the U.S. marketplace, but the companies lack the operational expertise that existing franchisees can provide. Also, inner-city retailing is one of the few areas in today's New Economy where there is still unfulfilled demand. Franchised businesses have the potential to tap into a significant and under-served market. Some cities even offer businesses incentives such as corporate income and/or property tax credits and incentives for opening in areas where the city is cultivating urban renewal.

What legal issues should franchisees be aware of?

The knee-jerk reaction of cutting quality and services in response to a weak economy can also result in unwelcome legal consequences. For example, by scaling back on staff, a fast food franchisee may find itself in violation of its franchise agreement, and in danger of termination. The same holds true if a franchisee were to turn to unapproved suppliers or vendors to cut costs. Franchisees must also be mindful of their service obligations under their franchise agreements. Many franchisors regularly conduct QSC (quality, services, and cleanliness) reviews of their franchised units. Depending on the terms of the franchise agreement, a low score could subject a franchisee to termination. The franchisee that steadfastly maintains its customer service standards during hard times protects both the brand's good will, and its own business interests.

There is also a cautious balance that must be maintained when pursuing innovative financing strategies, as too much financing might upset your debt/equity ratio, which acts as a barometer to a franchisee's financial success. Certain franchisors have debt/equity ratio guidelines that must be met; otherwise a franchisee might be in breach of the franchise agreement. Be careful in seeking investors not to violate any requirements a franchisor might have that it consent to any changes in corporate structure, which may occur when bringing in new venture partners. This might be grounds for default under certain franchise agreements.

What can franchisees do to mitigate disputes? And the same for franchisors?

Franchisees and franchisors alike should avail themselves of any properly structured system Franchise Advisory Council or Franchisee Association that exists. Either of these can play an important role in heading off disputes between franchisor and franchisee before they happen, as well as serve as a liaison between the two sides once a dispute has become inevitable. As franchisee attorney Robert Zarco always cautions: **EVERY BUSINESS DECISION THAT A FRANCHISEE UNDERTAKES HAS A CORRESPONDING LEGAL CONSEQUENCE. CONVERSELY, EVERY LEGAL DECISION THAT A FRANCHISEE MAKES HAS A CORRESPONDING BUSINESS CONSEQUENCE.** Franchisees should never make any significant business or legal decisions without consulting financial or legal counsel who possesses substantial expertise within the franchise industry.