

Money Guide

1994 Edition

How to fight your **F**ranchisor and Win

In its information kit to prospective buyers, Great Harvest, a bakery franchisor in Dillon, Mont., includes an application form warning that baking is "hard, sweaty work" and an observation that owning a Great Harvest franchise may "enrich a strong marriage and hurt a weak one."

Alas, such candor is rare. Dazzle, not detail, is the hallmark of most franchisors' sales pitches. And wide-eyed franchisees-to-be are often just as short on reality. "People want to believe in the golden opportunity," says Ann Dugan, director of the Small Business Development Center at the University of Pittsburgh, "and that makes it easy for franchisors to gloss over the drawbacks in the deals they offer."

First, you plunk down the \$10,000 to \$25,000 that 80% of franchises cost and begin paying royalty and advertising fees to the franchisor that skim 7% to 15% off your gross revenues. It's only then, generally, that you come up against problems unmentioned in the sales presentation such as disappointing revenues or skimpy advertising support from the franchisor. Or maybe you sense them shaping up, as you hear rumors that the franchisor is going to set up someone in a new franchise just down the road from you.

Either way, you may worry that there's little you can do to fight back once you've signed a legally enforceable contract favoring the franchisor's interests over yours, as virtually all do. Sadly, that's probably true with an unscrupulous franchisor, or one who simply doesn't have the skills or cash to deliver on his promises. "The '80s boom encouraged a lot of new and expanded franchises," says an aide to Rep. John LaFalce (D-N.Y.), chairman of the House Small Business Committee. "Today the market is full of unqualified franchisors who don't know what they're doing and qualified ones squeezed by too much competition." Indeed, since 1984, the franchise business has more than doubled from 2,503 franchisors to 5,045 today.

Still, whether your franchisor is saint, scoundrel or somewhere in the middle, you may have more leverage than you think. After talking to more than 30 franchisees, franchisors, lawyers, regulators and others with experience in the field, we've identified eight strategies to head off, cope with or recover from most of the headaches that can come with even a successful franchise.

No matter how good the relationship may be, you're still the junior partner. Follow these eight strategies to protect your interests.

by Lani Luciano

Pay attention to how the franchisor runs his business. Whatever happens to your franchise company will sooner or later affect you. So stay in close touch with the home office. Develop a personal relationship with someone on the inside if you can. That's usually your best route to obtaining straightforward information that can be very important.

Get a copy of the Uniform Franchise Offering Circular, the prospectus compiled each year by every franchise company for would-be franchisees. The UFOC will report important information that by law must be disclosed, such as the number of franchises sold, bought back or terminated and the details of any lawsuits pending or settled. By comparing UFOC data from year to year, you can get a current snapshot of how contented your fellow franchisees seem to be and what, if any, major problems they're encountering. This will alert you to issues that may confront you in the future.

Pay attention to the company newsletter, even if it's mainly a gossip sheet. See whether there's an exceptional number—more than 15% a year, say—of arriving or departing employees in middle management. This often signals that something is amiss at headquarters, such as a lack of consistent direction, little management consensus or financial distress.

If you do spot signs of instability, depending on the severity, you may want to put expansion plans on hold or even consider selling out before trouble drives down the price of your investment.

Equalize the odds. Even if your relationship with your franchisor is idyllic, never forget that his power is greater than yours, and always do whatever you can to strengthen your position.

For instance, ask for everything in writing, and save everything you get. Even documents that seem innocuous can be useful persuaders in the future, says Robert Zarco, a Miami attorney who represents franchisees. Zarco recalls

one client who, three years before his 20-year franchise contract expired, solicited a routine letter from the franchisor stating that it would be renewed for another 20 years. In the intervening three years, however, the franchisor changed its mind. Six weeks before the contract expired, the franchisor verbally offered a seven-year renewal instead. "I advised the franchisee to send a copy of the letter promising a 20-year renewal, plus a formal acceptance letter, to the franchisor to give him extra leverage in the coming fight, which he eventually won."

Deal with problems right away. Speak up immediately, for example, if you're a new franchisee and your location isn't producing the traffic you need. "Ask your franchisor to use his influence to negotiate a better deal with your landlord or a swap for another property," says Carl Price, an attorney with the Franchisee Resource Group, a consulting firm in Haddonfield, N.J. "Once poor traffic has pushed you into the low-volume category, you'll have less clout."

Guard your territory. Some franchisors make their profits primarily by selling products and services through franchisees, so it's in their interest to see individual businesses grow. Others make most of their money by selling franchises, which makes individual growth less important or not important at all, so you must protect your turf zealously.

Once another franchisee opens up shop nearby, it will be just about impossible to remove him, so be on the alert for signs of expansion in your area. Make friends with local real estate salespeople and lenders who can alert you to inquiries from would-be franchisees. The instant you hear of one, protest to the home office immediately. Even if the infringement doesn't violate your contract but would cause provable financial harm, you may have a strong position. Consult an experienced lawyer.

Keep a sharp eye on contract renewals. When business is prospering, a franchisee can easily ignore the fact that he owns a limited license, not a perpetual right. That can be a bad mistake, sometimes a fatal one, at contract-renewal time, particularly when a franchisor wants to eliminate a contentious franchisee or to earn higher royalties. Again, your best defense is a strong offense. Consider the example of William O'Brien of Chicago. Last winter, he got notice that Midas International, the muffler company, would not renew his contract on two Illinois franchises because he'd been late with payments. He immediately filed for arbitration by the American Arbitration Association then alerted the House Committee on Small Business. Before the arbitration could be scheduled, Midas agreed to renew his contract for 20 years. "I showed I was ready to fight to keep the franchise," explains O'Brien. "They didn't want a fight." Midas declined to discuss the case, but says president Ron Moore, O'Brien's

account of the incident is "factually inaccurate."

Join with other franchisees to settle disputes. If your franchise has an independent franchisees' association, as about 70 do, become an active member. "There's strength in numbers," says Susan Kezios, founder of the 7,200-member American Franchise Association in Chicago. "It's hard for a franchisor to claim that you're just a lousy businessman if everybody's having problems and you can prove it."

If your franchise lacks an association, consider starting one. (For a free booklet, *Forming a Franchisee Association*, send a stamped, self-addressed envelope to the Franchisee Resource Group, 35 Kings Highway East, Haddonfield, N.J. 08033.) Or you might consider joining the AFA (\$35 annual fee for each outlet you own; 800-334-4232).

Mediate, arbitrate or, if absolutely necessary, litigate. Mediation, the friendliest of the three, is a nonbinding attempt to negotiate with the help of a neutral facilitator. You can find a mediator through the American Arbitration Association (212-484-4006) or another group or agency specializing in dispute resolution.

If your dispute has gone beyond the point of negotiation, you'll have to turn to either arbitration or litigation. While arbitration is far quicker and cheaper than legal action—settlements come within 30 days on average and cost each party around \$500, compared with three years and \$100,000 or more for many lawsuits—no appeals are allowed.

Even if your contract allows litigation, it may require you to bring your suit in the franchisor's home state. "That adds the cost of travel and time away from your business," says Robert Purvin, an attorney with the American Association of Franchisees and Dealers. "What's worse, it's common for a franchisor to countersue, which keeps you fighting two battles and drains more cash." The AAFD (\$120 annual dues; 800-733-9858) offers members a free initial consultation with attorneys in 25 states who specialize in franchise law. By year-end, the AAFD hopes to make the service available nationwide. (For more on resolving conflicts, see "Q&A: Gaining an Edge at Arbitration" on page 33.)

Make contingency plans for your future. No matter how well things are going, don't ever forget that what you primarily own is a license, not a business. That's why it's only prudent to develop alternative plans for your future—just in case your contract isn't renewed or you become unhappy with the franchise.

If you've learned business skills, made useful contacts and have set aside spare earnings, you have a solid foundation for your next move. But it is also wise to draw up a plan of what you would do if forced to make a change. Says Susan Kezios: "There aren't gold watches being awarded in corporations anymore. Don't count on your franchise being forever either." ■