**CRAIN'S CHICAGO BUSINESS** Good Morning, Michael **Newsletters** THIS SEPTEMBER, SMASH THE GI CEILING WITH THE CHICAGO NETW Restaurants McDonald's franchisees' unprecedented push for more power By Ally Marotti McDonald's Credit: Mike Mozart/Flickr 🗍 Reprints 🔓 Print 📫 Share June 01, 2023 05:46 AM | 52 MINUTES AGO McDonald's franchisees are making an unprecedented bid to alter the balance of power in their relationship with the Chicagobased hamburger giant. Leading the push is the National Owners Association, an independent franchisee advocacy group that launched about five years ago and represents roughly 1,000 of McDonald's 2,000 franchisees. Advised by a well-known franchise lawyer, NOA is backing state legislation that gives franchisees more protection and is working to get the Federal Trade Commission to rewrite franchise rules in their favor. More → McDonald's faces risk in a prolonged legal battle with Byron Allen. It plans to fight. An investment firm offers \$12M to buy Corner Bakery out of bankruptcy Nisos to reopen in July as steakhouse McDonald's and its franchisees have always had their ups and downs, but experts say the latest faceoff goes deeper than familiar debates over new product offerings and store upgrades. This time, franchisees are trying to gain more control in a partnership long dominated by the company. "It's not just a menu or restaurant format topic," said RJ Hottovy, head of analytical research at location analytics company Placer.ai. "This is a little bit more personal." **ADVERTISING** Elevate every aspect of the real estate experience like never before. ı**€**× In a sign of how divisive the battle has become, the Wall Street Journal reported last month that McDonald's U.S. president, Joe Erlinger, said in a call with franchisees that those supporting legislation were dividing the company. "You see attacks happening, and those attacks are coming from within," the Journal quotes Erlinger as saying. Franchisees feel threatened by corporate moves to tighten franchise terms and get tough on renewals. They also resent edicts requiring them to spend more money as inflation squeezes their margins. The fortunes of McDonald's and its operators have diverged recently — franchisees say their cash flow has shrunk while same-store sales increases boost corporate profits and McDonald's stock price. Daily Gis LISTEN NOW Tensions are rising as McDonald's looks to accelerate growth by stepping up new-store openings, an initiative that needs support from franchisees, who operate about 95% of McDonald's 13,400 U.S. restaurants. Experts warn that a rift between McDonalds and its restaurant operators could alter or slow the chain's growth plans. Keep up with the stories that unfold throughout the day. Sign up for our Afternoon 10 newsletter. Subscribe "It's usually not a good business practice to piss off your core stakeholders," said Sean Dunlop, an analyst at Morningstar. The NOA has given some franchisees the courage to push back on McDonald's in ways they haven't before, said Robert Zarco, a franchise lawyer the group hired as counsel earlier this year. "In the past, they were very concerned about retaliation, intimidation and threats," said Zarco, speaking on behalf of NOA. "Now, because there is strength in unity, they feel more protected by each other." Last summer, McDonald's raised the bar for renewal of franchisee agreements and implemented a stricter performance review process for restaurant owners. It also changed criteria for franchisees to pass their businesses to spouses or children, saying it would evaluate all potential new franchisees the same way. Erlinger said at the time that the changes to the renewal process were "in keeping with the principle that receiving a new franchise term is earned, not given." As for nextgeneration owners, Erlinger said that adopting a uniform approach to evaluating new franchisees "regardless of the pathway" would provide "a consistent process." A new law in Arkansas touches on both topics. The National Owners Association supported the bill, which Gov. Sarah Huckabee Sanders signed into law in April. The law says a franchisor's approval is not required to transfer ownership to a spouse, child or heir. Another change in the law bars franchisors from terminating franchisees without cause "as determined under objective standards." Some McDonald's restaurant owners also supported an Arizona bill that protects franchisees. The bill failed to pass during the most recent legislative session, but the sponsor, state Rep. Stacey Travers, D, said she plans to introduce it again next session. Additionally, NOA is encouraging members to submit comments to the FTC, which is soliciting information about franchisee and franchisor relationships. Of the first 100 comments submitted, more than a dozen were from McDonald's franchisees. They raised concerns about noncompete clauses, increasing costs and the changes the company made to its store inspections. "Although I believe that McDonald's has the right to insure (sic) their standards are met, I do not believe that the level of intrusions by this franchisor is reasonable," wrote William Brown, a franchisee from Pennsylvania. In a letter to members in February, NOA's board said franchisee cash flow dropped by about \$100,000 per restaurant in 2022 and was expected to fall again this year. "The gap in operating revenue performance is not sustainable," said the letter, which Kalinowski Equity Research published in a report. "We should not, and can no longer, be accepting the burden of the entire impact of inflation." Throwing new standards at franchisees while they're dealing with inflationary pressures is a recipe for pushback, experts say. "We've had two years of double cost inflation . . . things are just tough, particularly in the quick-service restaurant world," said John A. Gordon, principal at consulting firm Pacific Management Consulting Group. "Where there have been strained relationships for a long period of time, the relationships haven't gotten any better." McDonald's told Crain's that it has made concessions for franchisees as it has rolled out recent changes. It adjusted the new performance review program based on franchisee feedback, and implemented it after a pilot period, so franchisees could get used to new standards before they took effect. CEO Chris Kempczinski said during McDonald's April earnings call that U.S. franchisees returned to positive cash flows in the first quarter. McDonald's sales and profit exceeded Wall Street expectations, with quarterly net income rising 63% to \$1.8 billion in the U.S. Sales at U.S. restaurants open at least a year — a key metric that tracks store-level growth — jumped 12.9%. At about \$285 on May 31, McDonald's stock was up almost 8% year-to-date, compared with a more than 9% rise for the Standard & Poor's 500 Index. "We're operating from a position of strength," McDonald's said in a statement to Crain's. "We remain focused on driving momentum and making the right decisions for the future of the business." Not all McDonald's franchisees are at odds with the company. McDonald's provided a statement that a group of 10 franchisees put out last month that said, "We are disappointed that a small but vocal group is pushing this counterproductive agenda, which threatens our business model and the livelihoods of future generations of franchisees." Additionally, the chair of the National Franchisee Leadership Alliance, a companybacked franchisee group, said in a statement provided by McDonald's that the group has had "several productive meetings" with company leadership this year and "we are clearly moving in the right direction." It will be hard for franchisees to wrestle control away from McDonald's, said Mark Kalinowski, CEO of Kalinowski Equity Research, which has been publishing franchisee surveys for two decades. Unlike many other franchisors, McDonald's also serves as a landlord to many of its franchisees. "That gives McDonald's a lot of leverage," he said. By Ally Marotti Ally Marotti is a senior reporter for Crain's Chicago Business covering consumer products, food, restaurants and retail. She joined Crain's in 2020 from the Chicago Tribune. News, McDonald's, Chris Kempczinski More in Restaurants → An investment firm offers \$12M to buy Corner **Bakery out of bankruptcy** An investment firm that once held a stake in the Famous Dave's barbecue chain submitted a stalkinghorse bid to buy the fast-casual Corner Bakery chain. Cooper's Hawk closing Chicago location In order for the Gold Coast location to be "truly viable and successful in the city of Chicago, it needed to become something that was outside of how we think of our business model," said CEO Tim McEnery. 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