FRANCHISING GUIDE

What to Look For in a Franchisee or Franchisor

By BARRY KURTZ AND DAVID GURNICK

Franchising is a large part of the economy. According to the International Franchise Association, franchising accounts for more than six percent of nonfarm jobs, four percent of U.S. payroll and nearly four percent of U.S. Gross Domestic Product.

Thousands of franchisors select from among millions of potential franchisees. To get the best, franchisors should develop a profile of the ideal franchisee for their particular system. Here are some key characteristics to look for in prospective franchisees for any franchise system:

Honesty and integrity. Franchisees represent the franchisor's brand. They serve the public, receive payment, and share the revenue with the franchisor in the form of percentage royalties. For all these reasons, honesty and integrity are essential.

Strong work ethic. Franchisees do the daily work where the franchisor's brand meets the public. A good work ethic is critical so that this work will be performed enthusiastically, and with dedication.

Willingness to follow the franchisor's system. A successful franchise system is an organization in which franchisees give up some independence in reliance on the wisdom, experience and good judgment of their franchisor. It is important to select franchisees who are willing to follow the precepts and procedures that comprise the franchisor's system.

Over the course of a lifetime, many people will buy a franchised business for themselves or invest in a franchise to be run by a family member, friend or partner. In evaluating the many available franchise opportunities, here are some qualities to look for in a franchisor.

Good business and activity fit. Restaurant franchises involve lots of hands-on work and engagement with customers and suppliers. After-school enrichment franchises require working with school administrators, teachers and kids. Real estate franchisees do lots of selling, and driving around customers. Office work is part of almost every franchise. Look for a business in which the daily activity aligns with what you like to do; avoid franchises with activity you dislike.

Competence. Check carefully that the franchisor has deep knowledge of the business they operate in. Look for a record of adjusting and overcoming challenges in the past and a plan or procedure for addressing surprises in the future.

Balance of firmness and flexibility. Good franchisors are serious about enforcing requirements of their franchise system, to achieve uniformity of operations and customer experience among all franchisees. The best franchisors do this with good cheer, finding the way to keep good relations with franchisees. They also know when to listen, welcome ideas, and flexibly embrace the needs of franchisees.

Satisfied franchisees. One of the most important signs of a healthy franchise system is a high level of satisfaction among franchisees. This comes easier in profitable systems, but surprisingly, in some profitable systems many franchisees are frustrated at the demeaning attitude and harsh treatment from their franchisor. Check with current, and former franchisees about their satisfaction with the franchisor.

Profitability. Because franchisor revenue is a percentage royalty, a franchisor can be profitable even when franchisees are not. It is important to know if the franchisor and franchisees are profitable, and how much. Look at the franchisor's financial statements (their disclosure document provides these going back three years). Some franchisors also provide franchisee earnings information in Item 19 of their Disclosure Document. But that information can be carefully structured to look good. Interview several existing and former franchisees to about their income and profitability.

Long term commitment. Many franchisees invest based on respect for the franchisor's management and then find themselves dealing with different people. Some franchisees who loved the culture at the Century 21, Coldwell Banker, ERA and Better Homes franchise systems, were disappointed when the owners sold. Today these brands are all owned by the same public company, Realogy and many franchisees feel the culture has changed. Investigate whether the management who recruits you will be there in the future to work with you.

Relatively Balanced Agreement. Franchise agreements tend to favor franchisors. Their lawyers write the agreements as a tool for the franchisor to maintain system uniformity among individual franchisee owner operators. But agreements that are too one-sided place franchisees at the mercy of the franchisor's whims and judgments. This makes even a currently profitable franchise highly risky to invest in. Look for another system where the agreement is more balanced.

Financial Strength. Make sure the franchisor is financially strong. The franchisor needs funds to maintain the system, update its services and products, provide support to franchisees, advertise to the public, and respond to business challenges.

Experience. A franchisor whose management has deep experience in the business and industry is preferred over systems whose management experience is weak, or from other industries.

Care and thoughtfulness by franchisors and franchisees in selecting each other lead to the most successful franchise relationships.

Barry Kurtz and David Gurnick are Certified Specialists in Franchise and Distribution Law, designated by the State Bar of California Board of Legal Specialization, at Lewitt Hackman in Encino. Kurtz is the Chair of the Practice Group. Contact them via email at bkurtz@lewitthackman.com, or dgurnick@lewitthackman.com.


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Barry Kurtz, Chair *
David Gurnick *
Tal Grinblat *
Bryan H. Clements
*Certified Specialist in Franchise & Distribution Law - State Bar of California Board of Legal Specialization
16633 Ventura Boulevard, Eleventh Floor ▪ Encino, California 91436
www.lewitthackman.com ▪ 818.990.2120