

Franchising During and After the Pandemic

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One thing we have all learned is that during a crisis we Americans usually step up and lend each other a helping hand. Although this article will not go into detail, this author is proud to say that there are hundreds, if not thousands, of examples of both franchisors and franchisees who have donated and are currently donating their goods or services to those in need. But what about the many franchisors and franchisees who cannot donate, are struggling to survive and pay their employees because they are not permitted to provide their goods or services, their supply chains have been interrupted, or their method of operation does not allow for a safe work environment. What does franchising look like during the current COVID 19 pandemic and afterward?

There is little question that the current pandemic is something that no business, including franchised businesses, could have anticipated. The crisis that franchising is facing now has demonstrated a number of flaws to franchisors/franchisees in their business models, methods of operation, training procedures, supply chains, not to mention deficiencies in the agreement terms which define the relationship between franchisor and franchisees.

According to a QSR April 1, 2020 industry news report, a March 2020 online survey conducted by FranConnect, a provider of franchise management platform solutions, found that, although approximately two-thirds of franchisors continue to sell franchises, 75% of full-service restaurants brands have stopped selling franchises. The survey also showed that personal services brands have been hit the hardest with over half of the respondents indicating they have closed at least half of all of their locations.

It appears that business services and commercial and residential services have not been hurt as badly with more than half of the respondents reporting that they only had to close 10% or less of their locations. Across the board, however, about three-quarters of the respondents indicated they saw a drop of more than 20% in sales. The survey did provide some light at the end of the tunnel in that most businesses expect to return to normal business levels within six months.

So what does the future hold for franchising after the pandemic passes? Here are some thoughts about what franchisors and franchisees might be considering:

Franchise disclosure documents (FDD) and agreements will likely be altered. Franchisors will likely make their FDDs more clear about the impact of the current pandemic and future ones on all kinds of disclosures in the FDD—namely the amount of working capital that may be required, increased insurance expenses, the potential frailty of their financial performance representations for past years and the number of closures. Franchise agreements will also need to be reviewed for how they deal with force majeure and related termination and bankruptcy provisions. Leases will also be scrutinized like never before to level the playing field between landlords and franchise tenants who never imagined a pandemic would impact their lease.

Methods of operation may require substantial overhaul. It is likely that every business will now have to alter how it allows its employees to work—perhaps different groups of employees working on different days. And there will likely be new rules about customer engagement and

customer safety, along with new procedures for testing employees and customers. The workplace may require physical design changes to accommodate for safe distancing between employees and customers. Hours of operation may have to change, perhaps shorter hours per day, or fewer days per week. The workplace uniform may change to comply with new health regulations and require masks, gloves, possibly even new types of virus-resistant garments. For some systems, modes of delivery will change in ways that will require additional capital expenditures, such as adding additional capacity for drive-thru or curbside delivery.

Some businesses may implement or enhance methods for the virtual delivery of services to customers. We all heard Governor Gavin Newsom announce that restaurants may have less tables, and be required to use disposable menus. Massive automation of many franchise operational tasks might be the next wave to hit franchising—which will likely lessen workforce requirements. One example could include eliminating wait staff in restaurants. Could food be ordered on a tablet, and then be either picked up by the customer or delivered to the customer by an automated robot? At least one hamburger franchise is already doing something like this. Fine dining may never be the same.

Sophistication and financial fitness for franchisees. For many franchisees it seems as if they were caught completely unprepared financially for this crisis. So many had no money saved in the bank, no “rainy day” fund. Many appear to have been in debt already, or are barely breaking even from month to month, and were in no condition to shut down for a month or two and be able to pay salaries or rent to maintain their businesses. Consequently, we should expect franchisors to be a lot more selective with franchisees going forward, and require higher working capital and financial health to weather such crises in the future. Indeed, similar to the “marketing fund” many franchisors utilize for all franchisees, perhaps franchisors will require franchisees to participate in a new “crisis fund” so they can all have something to tap into for the next crisis, and not be dependent on government bailouts or bank loans.

Development of new franchise businesses. Crisis usually begets innovation. We are already seeing how telemedicine is taking off. It is not difficult to see how new franchise businesses in cleaning, delivery and other home services or stay-at-home businesses are likely to develop. And although travel businesses may continue to flounder for a while, it wouldn’t be surprising to see new “safe travel” businesses grow, targeting and servicing customers who want or need to travel without fear. And although dine-in restaurants are also struggling with likely more than a third of such businesses never to open again, restaurants are turning to ghost kitchens and third-party delivery businesses and/or developing their own native delivery services to stay in business.

Supply chain. Another noticeable deficiency in many businesses that arose during this pandemic was the failure of the supply chain many relied on to operate their businesses. It should be clear to franchisors and franchisees that no business should rely on only one source for all their necessary goods or services, and many will likely be employing second source supply agreements to make sure they are not held hostage to the sole supplier that had to close or discontinue services during the pandemic. Indeed, many franchisors may decide to rely on their own local resources to become the supply chain to their franchisees, and not rely on third parties. One would expect more franchisors to employ cutting-edge technology designed to provide better and more sophisticated predictive modeling for their business supply needs going forward, and to charge fees to franchisees for utilizing such technology to become more efficient, better manage inventory, and hopefully realize significant savings.

We are all in this together. I look forward to seeing franchising adapt to the new normal whatever it actually becomes. Stay safe and healthy.

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