

Would a Franchise Lawyer Make a Good Franchisee?

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One of the most important tasks for a new franchisor is selecting his (or her) initial franchisees, and this selection challenge to pick winning franchisees will continue to exist even as the franchise system matures.

Formative Stage: Selection is Key

If one asks franchisors when did they make their biggest mistakes when entering into the world of franchising, many would say it is at this early stage in the franchisee selection process. An interesting study would be to focus on how many of the first batch of franchisees are still in the system three or five years later. Many franchisors and other members of the franchise community believe that when the franchisor makes its initial franchisee selections, bad judgment on prospective franchisee selections can have deleterious consequences and can result in actions that will severely hinder the speed at which the company can become successful, if at all.

If one steps back and paints a picture of the franchisor during this first stage of franchise sales, this consequence does not come as a surprise. Many franchisors have no standards at this stage to predict who would make a good franchisee. Does the prospect have any business experience? What does his personal financial statement look like? Does he have sufficient resources to fund what it will take to get the franchise operational? Where would the prospect locate his first unit? What does he know about the business sector he would be entering? Will he be willing to commit full time to the franchise, which may mean giving up his existing job? These are only a few of the questions a franchisor must address when he selects the first of his franchisees.

In this formative stage, there are also significant pressures on the franchisor to get the franchises up and running. Usually there will be loans outstanding, and in brick and mortar businesses, rent to be paid. Employees as well as suppliers must be paid. In the trade, there is an amusing question: Who will make a good franchisee at the beginning? Answer: Anyone who passes the mirror test—fogging the mirror when they breathe. That is, financial pressures on the franchisor may result in him selecting almost anyone who breathes to be his initial franchisees. This is particularly true if there are no company stores operating to generate cash flow as the franchise system is built up.

Moreover, company stores are critical to a new franchisor because their operations can validate whether the company's business can have viable franchises. If company stores cannot make money, then it is likely that franchisees cannot either.

While company stores are probably the best way to prove the viability of a company's unit operations, they will be operated by a manager, who will be an employee of the company. This manager may have different factors affecting his performance than would a unit operated by a franchisee owner. This may, in turn, affect a unit's success. If a company store fails, for the franchisor the result will be that the manager will simply begin looking for his next opportunity.

In contrast, the franchisee will be in the game for the long haul. Besides having obligations to the franchisor under the franchise agreement, in a typical scenario the franchisee will be taking out loans to finance the franchise's construction and initial capital. Rent on the property's location will need to be paid. Initial inventory must be purchased, and employees will be hired. These and other expenses will be incurred. For a failing company unit, these expenses fall upon the company, not the manager. For a

franchisee, all the expenses fall on him and him alone. In other words, failure will likely result in financial ruin to a new franchisee.

A failure of a new unit is not only an albatross to the failed franchisee, it may adversely affect the franchisor's ability to sell new franchises. Failures by franchisees in the early life of a franchisor may have many causes, and one failure might not signal doom to the franchise system, but it will be no friend to the franchisor as he solicits new franchisees.

All of the above discussion is important because it not only demonstrates how difficult it may be to find new franchisees, but the consequences of finding and signing up bad ones.

Pros and Cons

But the question asked at the beginning of this article was much narrower. It was whether a franchise lawyer is likely to be a good or bad franchisee?

In a recent discussion with several franchise law students, the question elicited a mixed bag of answers with several different analyses of why franchise lawyers might fall into one camp or the other.

Several of the students thought recruiting a franchise lawyer would be a good idea. He is educated. He is perhaps more likely to understand the significance of a franchise agreement and the need to follow the system as set forth in the franchise agreement and the system's operations manual. Thus, he would be entering the franchise community without blind eyes unlike many novices.

On the other hand, to the world beyond the legal community, lawyers are often looked upon dubiously. They are viewed as trouble makers, only interested in money; and they have a negative view of the world, and, like many non-lawyers, they may be suspicious of the franchisor's character and motives—perhaps even more so. They might perform a better due diligence investigation of the franchisor, but their training over the years in looking for the dark side of an opportunity may scare them away and result in their not buying the franchise. Moreover, if they do become franchisees, they may be fixed in their ways, not easily convinced that the franchisor's system must be followed in order to achieve success. Stated differently, the franchisee lawyer may conclude that because he is a lawyer, he, rather than the franchisor, knows all the answers.

And what happens in the years that follow if there is trouble in the franchise system? Will the lawyer act in the same way as other franchisees in deciding what course the system will follow, or will he add a different perspective to the crises based upon his years of experience as a franchise lawyer? The franchise lawyer franchisee might become the leader of the opposition, finding fault in any proposals made by the franchisor, or he might become a supporter of the franchisor, recognizing that a franchisor system is like a three-legged race, with cooperation by the franchisor and its franchisees is necessary for success. And will the fact that he is a lawyer and, in particularly one skilled in the franchise relationship, be viewed by other franchisees as making him a leader of the pack by his brethren.

One point should be noted. In the real world, there are few decisions that are safely predictable.

The public's impression of lawyers is, unfortunately, misrepresented by the billboards and other advertisements suggesting that through litigation, they will work a miracle for their aggrieved clients. But in fact, the advantage that a franchise lawyer franchisee would have in this situation is his experience working with the franchise sector and having seen how other systems have worked out controversy without the parties digging trenches.

The recent advertising campaign by Farmers Insurance says Farmers is a better company because it has "seen it all." Thus it has experienced more situations in the years they have been settling claims with their

customers. The same thing may be said of a franchise lawyer's franchisee; it may be a better franchise because he is able to use this experience to help out a franchise system facing a problem. However, in one of the Farmers Insurance ads, the client and the insurance company must deal with an angry moose, and it is doubtful that any lawyers have had to face a situation of an aggrieved moose on a rampage. In other words, even by the best of franchise lawyers, experience may not cover all issues.

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