



Insights: Alert

More Thoughts on COVID-19: Franchising for the Long Game

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Please note: The below information may require updating, including additional clarification, as the COVID-19 pandemic continues to develop. Please monitor our main [COVID-19 Task Force page](#) and/or your email for updates.

The COVID-19 crisis is presenting an unprecedented challenge for the franchise community. The local franchisee is where customer service is delivered and brand loyalty cultivated. Franchisees are facing different rules of operations as some communities issue orders closing establishments, imposing curfews and restricting travel and consumer activity. Although immediate effort is being expended by franchise systems to implement the new, ever-changing health and safety measures recommended by the CDC and administration officials, COVID-19 is presenting a number of other challenges that need to be addressed as well. These challenges and suggestions for addressing them are discussed herein.

Be Adaptable and Proactive

In recent days, many franchised businesses, particularly in the food services industry, have adapted the delivery of those goods and services to help contain the spread of COVID-19. Starbucks was one of the first chains to remove seats from stores and shut down busy locations. In the past few days, Chick-fil-A, McDonalds and Taco Bell have announced they were taking a “proactive” role in protecting communities and employees by shifting to “to-go” and delivery-only models. All of this might make a franchisor that doesn't take similar actions feel left out. In the court of public opinion, a franchise system that doesn't follow suit could face greater scrutiny especially if it is perceived that its act (or failure to act) directly put the community or a particular individual or group of individuals (for example, the franchise employees) at risk regardless of whether legal requirements were met. Clearly, defending a future legal action may be expensive, but the potential financial toll resulting from long term damage to a franchise systems' reputation could be far greater. Franchise systems in all industries would be well served to proactively adapt their systems to allow franchisees to provide some level of service while maintaining the possible impact of COVID-19.

Look to Implement Long Term Solutions

Many franchisors are also likely to find themselves in the position of weighing whether to enforce the contractual terms of franchise agreements strictly or offer flexibility to franchisees to help them weather the current storm.

Consider the example of the North American Association of Subway Franchisees, representing roughly 23,500 operators, which is demanding that their franchisor slash royalties—a demand many franchise systems will likely face. Smart franchisors will understand the need to be flexible with payment and opening deadlines, and may be willing to consider royalty abatements or other concessions. However, although franchisee requests for accommodation and flexibility may be reasonable in light of COVID-19, many franchisors also face their own cash shortages due to sharp declines of sales at corporate units as well as falling royalty revenue. Franchisors that do not have significant cash reserves or access to capital may be unable to give some or all of financial accommodations franchisees seek at this time.

With franchises reporting system sales dropping by as much as 80% in a matter of days, franchise businesses in many industry segments will face critical cash shortages. The most significant variable for many businesses in terms of cash flow at this time seems to hinge on timing—when will things begin to begin to stabilize and return to “normal”? Experts disagree on when, but many believe that fundamentals remain strong, and that the worst will be over by the middle of the year. Looking beyond the immediate threat to public health, the goal for many franchisees in the coming weeks and months will be survival, and, for franchisors, protecting their most important assets – their brand reputation and franchise system—from widespread closures.

Public Relations - Perception Is Everything

As a result of COVID 19, franchisors face important decisions. Franchisors must consider how these decisions during the pandemic are perceived by customers, franchisees and the public-at-large, and whether and to what extent those perceptions persist long after the pandemic subsides. At the same time, many franchise systems are approaching “survival” mode and must assess and plan for the financial impact of customers and employees staying at home, working reduced hours as well as the potential expansion of mandated closure of dining areas, “shelter in place” and similar laws that will continue to depress, and perhaps even further erode, average unit volumes.

It used to be so easy. In the pre-COVID-19 world, franchise systems could maintain a positive image by simply ensuring great customer service. Public criticism in the areas of employee and consumer health, safety and welfare could largely be avoided by complying with current minimum legal requirements. But now decisions made by franchisors could have a direct and far-reaching impact on public health, and maintaining a positive public image during COVID-19 may require going beyond what may be required legally. At a time when uncertainty is causing some businesses to act in extreme self-interest and cash reserves are dwindling, franchisors may be forced to evaluate whether taking steps designed to improve their bottom line in the short term to protect themselves is more important than the potential for long term reputational damage.

For example, playing the long game may require franchise systems to evaluate offering more to their employees than what is legally required. Outside of the franchising companies such as Google are voluntarily enabling workers to take paid sick leave if they have COVID-19 or if they are quarantined. Microsoft has announced that it is paying hourly service providers their regular pay during this period of reduced service need. These and other similar non-mandatory employee benefits might go far in preserving a franchise systems' workforce, and engendering future loyalty by employees and the public-at-large.

So, What Can You Do?

To best address these challenges, one thing is clear: franchisors and franchisees need to work together. They will need to be creative and adaptable with the goal of coming out of this crisis just as strong as they entered it. A few suggestions for achieving this goal include:

- Franchisors and franchisees should revisit the lessons learned from the financial crisis of 2008, such as cutting costs, experimenting with new products, limiting hours, and downsizing unnecessary staff. This may also mean shifting funds away from variable costs like marketing and advertising and other non-essential services. Efficiencies may also be gained by limiting operating hours.
- Fixed burdens such as rent may also be reduced through negotiation, and franchisors should strongly consider providing their franchisees with specific guidance and training in this area. In this type of situation, landlords are likely expecting conversations from business owners regarding rent reductions or rent-free periods, and some may consider rent free periods and short term rent reductions by as much as 50% in this climate. Given the choice between closure and no rent for several months, and a rental reduction, most landlords will choose the latter. Success will likely depend upon the landlord's overall occupancy rate and the prior history of the landlord-tenant relationship. Agreeing to extend the lease may be a good strategy for enticing a landlord to accept a decrease.
- Many systems may be able to increase sales through strategic advertising and using alternate delivery systems including curb side delivery.
- Franchisors should prepare budgets that model cash flows during certain periods, such as 30, 60 and 90 days, if sales continue at current rates and also at the worst case scenario – which for non-essential businesses might include a forced closure for some period of time. Current cash reserves and lines of credit should be analyzed in this context. Franchisors should provide guidance and information to their franchisees about creating similar budgets and financial modeling and evaluating cash reserves.
- If cash reserves and lines of credit are insufficient, franchise businesses should attempt to secure credit. Also, the SBA has announced low interest loans for certain eligible “disaster areas” of up to \$2 million for businesses that do not have access to credit. Online information and applications are available at <https://disasterloan.sba.gov/ela/>
- Franchisees should also review insurance policies for business interruption coverage or contingent business interruption coverage in the event stores must close or suppliers are affected by COVID-19. Of course, this includes carefully reviewing policy requirements and exclusions to ensure franchisees get the greatest possible benefit.

Related People



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