

FRANCHISE LAW INSIDER™

A Publication Reviewing Recent Franchise Developments

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“We are what we repeatedly do.
Excellence, then, is not an
art but a habit.”

Aristotle



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RECENT COURT DECISION ON ENFORCEABILITY OF JURY TRIAL WAIVERS

By David E. Holmes

As most of our franchising clients are aware, avoiding the use of juries in resolving Franchisor/Franchisee disputes is generally a good thing, given the very real possibilities for emotionally based decisions and possible prejudice against the Franchisor, who may be perceived as “big business,” and in favor of the Franchisee, who will often be presented at trial as a small investor whose life savings are at risk due to the Franchisor’s alleged misconduct.

For that reason, many Franchise Agreements contain a jury waiver clause, in addition to the normal dispute resolution clause mandating mediation and arbitration. The jury waiver clause is designed to deal with the situation in which arbitration might be denied and a court trial required; in that case, if arbitration is unavailable, trial before a judge, in preference to a jury, will generally be favored by Franchisors.

The question then arises as to whether or not a jury trial waiver contained in a franchise or other agreement will actually be enforceable, or, to put it another way, can one party to an otherwise valid contract escape from its promise to waive jury trials? As you might expect, courts have differed in their answer to this question, and a recent California decision at least calls into question the issue.

In *Grafton Partners LP v. Superior Court* (reported February 10, 2004), a California appellate court struck down a pre-dispute contractual jury waiver in a commercial contract. The court held that the right to a jury trial may only be waived by a party to a pending suit (and only in the manner provided for by statute), and not by means of a clause in the contract. The case appears to contradict the holding in *Trizec Properties, Inc. v. Superior Court* (1991), which could lead to review by the California Supreme Court. How (and even if) the California Supreme Court chooses to rule on the issue is an unknown at the moment.

For now, we recommend that jury trial waiver language be retained (or inserted, if not already present) in all Franchise Agreements, on the following basis:

1. Any outcome before the California Supreme Court is unknown at this time.
2. Even if the California Supreme Court chooses to declare jury trial waivers ineffective, Franchisors who have (wisely) designated the law of another state to apply to their Franchise Agreements should be able to avoid the application of California law to agreements with Franchisees who are not resident or doing business in California.

As always, if you have any questions, or need further information, please don’t hesitate to call us. ■

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FRANCHISE LAW INSIDER™ is published to provide our clients and friends with information on recent legal developments affecting the franchising world. The articles and/or opinions presented are necessarily of a general nature and should not be construed as legal advice or opinions on specific facts.

We'll be happy to provide additional information regarding any of the articles contained herein, or to discuss how they may apply to your situation. We invite your comments, questions, or any short articles of a pertinent nature for possible inclusion in a future newsletter. Please contact our offices if you're interested.



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MANAGERS VS. LEADERS - WHAT'S THE DIFFERENCE?

By Herbert M. Greenberg, President and CEO, Caliper

Whether on the corporate, regional or operating unit level, one of the never ending challenges facing all franchise systems is the need to identify and develop leadership. Caliper is a nationally respected organization which assists clients, including Holmes & Lofstrom, in identifying the right people for the right positions.

Dr. Greenberg is Caliper's CEO, and at our request, shared with our readers his views on the difference between Managers and Leaders. What we found particularly interesting was the finding that leaders report that they were probably born with 40% of their leadership skills and that the remaining 60% came through experience.

More information can be obtained from Debbie Kochis at 609-524-1297 or at associationinfo@calipercorp.com

How can you recognize when a manager has real leadership potential? As one client put it, managers do things right, while leaders do the right things. He looks to managers as being implementers, and leaders as initiators.

There is, however, an overlap. In some ways it can be easier to pinpoint what a manager does. We can list things like financial analysis or market planning or human resources management for that matter. Leaders, on the other hand, create visions. They are inspiring. They do not merely provide direction, but, create the music, orchestrate the resources and create environments where new achievements are realized.

While managers and leaders share many similar qualities, the performance of a manager carries far fewer risks than the performance of a leader. In addition, there seems to be a difference in the underlying motivational characteristics of these two groups.

This is not to say that everyone, at some given point or time is not capable of leading. We believe that all of us can rise to the occasion, realize that this is our moment, and lead a crowd of people out of a burning building-or answer some other immediate cause. All of us can lead situationally.

The difference with true leaders however, is that leading is part of who

they are. It is part of their character, their style-it's real, underlying sense of purpose.

In a recent Caliper study, more than 300 presidents and chief executive officers told us what they considered to be the most important-and the most difficult aspects-of being a leader. Among the choices we asked them to rank were:

- Creating the right vision
- Getting people to embrace that vision
- Maintaining momentum (motivating, influencing and persuading others)
- Managing change (strategic planning, problem solving)
- Surrounding oneself with the right people
- Developing staff (coaching, managing performance, transforming teams)
- Delegating authority

Surrounding oneself with the right people was selected 41% of the time, second only to creating the right vision as one of the most critical parts of leadership. Surrounding oneself with the right people was also selected as one of the three most difficult aspects of being an effective leader-just behind maintaining momentum and developing staff.

These chief executives said there are three main factors that keep most managers from becoming leaders: not understanding others well enough, not solving problems quickly enough and not taking necessary risks.

We also asked the perennial question: Is leadership predominantly something you are born with or that you develop through experience?

These same chief executives told us they felt they were born with 40 percent of innate leadership ability and developed the remaining 60 percent through experience.

What are the personality qualities that account for 40 percent of innate leadership ability?

When we assessed the personality strengths of these chief executives, we found they were adept at influencing

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and directing others, skillful at building relationships and masterful at solving problems and making decisions. In essence, these leaders are extremely bright, assertive, driven to persuade, empathic and resilient. Having a need to get things accomplished, they are willing to take risks. They are also moderately sociable, demonstrating a healthy level of skepticism, and are motivated to come up with new ideas. That's a very strong profile—which, we have found, most managers just don't measure up to. Instead, most successful managers we have assessed

are rather conservative. They succeed by working within established guidelines. Which is exactly why they were hired.

And therein lies the dilemma most companies face.

How can potential leaders rise through the ranks of management? If they maintain the status quo, their leadership skills won't be recognized. If they rock the boat, other managers may feel threatened and try to subvert them.

Identifying and developing future

leaders is one of the most important challenges facing chief executives today. Yet most organizations have a tendency to suffocate potential leaders. Certainly a hallmark of an effective leader is to create a vision for the company's future. Essential to that vision is: recognizing the potential in future leaders, mentoring, coaching and developing them, giving them responsibility early, and realizing that a very different type of leader may be needed for tomorrow than exists today. ■

HELPING CLIENTS TO CONTROL THEIR FUTURE

E. Michael Shays CMC

Franchising sometimes seems to exist in its own world. While it's true that the techniques needed to develop a successful franchise system are significantly different than in those used other business models, and that one of the core elements in a Franchisor's success is understanding those differences, the fact remains that those of use in franchising still have a lot to learn from our colleagues in the "Fortune 500" world!

One of those lessons has to do with strategic planning for business growth and survival. The following article, forwarded to us by Janas Associates, a firm specializing in facilitating mergers and acquisitions for franchise systems and others, is particularly helpful in that regard. Additional information can be obtained from Carter Freeman or Paul Richey at 626-432-7000.

Futurists say they do not predict the future. They identify likely scenarios based on past trends and present forces. There is a ten step approach that will help answer the question, "What can we do to maximize shareholder value, to assure ourselves and our company of prosperity in times of opportunity, and healthy survival in times of adversity?" It comes as much out of the hearts of the principals of a company as it comes from their heads.

STEP 1: Develop the Larger Purpose of the Business

We need to ask what the company is in business to achieve, and what is the larger purpose of that? Larger purposes expand our understanding of the

business, and deliver a larger solution space.

STEP 2: Uncover the Personal Goals of the Principals

Notwithstanding what the owner and senior managers claim are the purpose and goals for the business, it is essential to discover what their own individual personal goals are. Is there a disconnect between what they want for themselves and what they want for the company?

STEP 3: Focus on Ways to Achieve the Larger Purpose of the Business

Focus on the future, not on the past. Discard current thinking baggage. Focus on solutions, not on problems. If there were no restrictions, how could the company achieve their larger purpose? What strategy would it take to make it happen?

STEP 4: Develop Strategies to Make It Happen

Fix the desired future as your base and work backward to the present state. It's like reverse-engineering a vision of the future to find out ways to build it. Don't try to build a future on a platform of the past or even the present.

STEP 5: Deal with Objections After Developing the Core Solution

Agree on issues that are potential problems, record them, and then assume for the moment that the issues don't exist. After developing the core strategy for the future most of these issues will have gone away. Others can be worked around without destroying

the basic solution.

STEP 6: Identify and Validate the Assumptions Embedded in These Strategies

Everything is an assumption, including the market, the product, the organization, the people, the financial condition and even the management. Identify and validate those assumptions that are critical to the success of the strategy. Develop new strategies to deal with new assumptions.

STEP 7: Develop Responses to Changes in Assumptions

Consider what the company would need to do if key assumptions turned out to be wrong. What should be the response to a worst-case scenario? What about a best-case scenario? Don't wait to be surprised. Be prepared.

STEP 8: Develop an Action Plan

Just do it. What are the tasks that must be completed to implement the plan? Who are the owners of these tasks, and when must their tasks be completed?

STEP 9: Achieve Buy-In

Throughout the entire process involve the people who will be affected by the changes represented by the plan. Get their commitment and support, their input, their buy-in. Celebrate endings before glorifying new beginnings. Preserve the dignity of past efforts.

STEP 10: Follow Up

Check in periodically to gently probe the implementation of the plan and

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stimulate action or suggest changes as needed. Activate new strategies to changed assumptions.

Controlling the future of a company means more than creating a vision, checking out SWOT, and establishing strategies to achieve long-term goals. It means more than creating a strategy. It means creating a future. To do that you must expand vision to the larger purposes the company serves, and to understand the personal agendas of the principals who must take the company into the future. To create a future you must think future and work backwards. You must recognize that everything is merely assumed and consider how to respond to alternate scenarios when these assumptions change. A strategic plan designed to create the future must be flexible, proactive, and vibrant. It is not a snapshot of what the company wants to be. It is a motion picture with unexpected events, resilient lead characters, and a satisfying conclusion. ■

ONTARIO'S REVAMPED "BLUE BOX" PROGRAM PLAN

For Franchisors operating, or planning to operate, units in Ontario, Canada, a new government imposed a recycling program that may result in significantly increased costs of doing business. Our Canadian correspondent counsel, Markus Cohen, Esq. has prepared the following summary of the new program and additional information can be obtained from him. He can be reached toll free at 1-877-413-6482 or at 416-413-9822.

Continued growth and even the sustainability of municipal recycling - until now borne entirely by municipal tax payers - was being threatened as municipalities look to reduce services in order to reduce costs. Funding for Blue Box programs was increasingly in competition with funding for other essential municipal services.

As a result of a collective plea from municipalities in Ontario, the Province's Minister of the Environment approved the revamped Blue Box Program Plan. This action signals that, beginning this month, "affected industry will be responsible for funding 50% of the net cost of Ontario's municipal Blue Box programs".

Stewardship Ontario (SO) is the province's first Industry Funding Organization (IFO), created in late 2002 in response to a request from the Ontario Minister of the Environment to Waste Diversion Ontario (WDO) - a permanent, arms-length corporation with a Board of Directors comprised of representatives from industry associations, municipalities, the Liquor Control Board of Ontario, non-profit organizations, and the Ontario Ministry of the Environment - to submit a waste diversion program for Blue Box wastes. The resulting Blue Box Program Plan outlines how companies - or "Stewards" as they are called - that introduce

packaging and printed paper into the Ontario consumer marketplace will share in the funding of 50% of the net cost of Ontario's municipal Blue Box waste diversion programs. "The Blue Box Program Plan defines and designates as 'Stewards' the brand owners, first importers and franchisors ... of products that result in consumer packaging and printed paper waste," explained Damian Bassett, CEO of SO.

SO is empowered to collect fees from the new 'Stewards' of the province, and distribute new industry funding to support the recycling programs of the municipalities of Ontario." [A "How to Register" workshop and web cast will be held on January 21, 2004 to help Stewards come quickly into compliance with their new obligations. Company representatives should return regularly to the Stewardship Ontario website for news on their next steps toward compliance.]

The Blue Box Program Plan encompasses consumer packaging material and printed papers commonly found in the residential waste stream, including all categories of waste designated as "Blue Box Waste" in Schedule 1 of Ontario Regulation 101/94 under the *Environmental Protection Act*. A copy of Schedule 1 is appended to this notification.

Small businesses (with gross revenue from sales of less than CA\$2 million; retailers whose cost of goods was less than CA\$2 million; or companies that generate less than 15 metric tones of Blue Box waste materials per year) are exempted from the plan.

A metric tone is equal to approximately 2,200 pounds U.S., or about 10% more than a U.S. ton. Consequently, if your company is expected to generate less than 33,000 pounds of Blue Box waste per Schedule 1 attached per year, your company is exempt from registration

under the program.

Schedule 1 — Blue Box Waste Part I — Basic Blue Box Waste

1. Aluminum food or beverage cans (including cans made primarily of aluminum).
2. Glass bottles and jars for food or beverages.
3. Newsprint.
4. Polyethylene terephthalate bottles for food or beverages (including bottles made primarily of polyethylene terephthalate).
5. Steel food or beverage cans (including cans made primarily of steel).

Part II Supplementary Blue Box Waste

1. Aluminum foil (including items made from aluminum foil).
2. Boxboard and paperboard.
3. Cardboard (corrugated).
4. Expanded polystyrene food or beverage containers and packing materials.
5. Fine paper.
6. Magazines.
7. Paper cups and plates.
8. Plastic film being,
 - i. linear low density or low density polyethylene grocery bags or bags used for food or beverages, and
 - ii. linear low density or low density polyethylene used for wrapping products.
9. Rigid plastic containers being,
 - i. high density polyethylene bottles used for food, beverages, toiletries or household cleaners (including bottles made primarily of high density polyethylene), and

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ii. polystyrene containers used for food or beverages (including containers made primarily of polystyrene).

10. Telephone directories.

11. Textiles (not including fiberglass or carpet).

12. Polycoat paperboard containers, being containers made primarily of

paperboard and coated with low density polyethylene or aluminum, and used for food or beverages. ■

ONTARIO, CANADA, RECYCLING PROGRAM COSTS TO BE SHIFTED TO COMPANIES

Although not strictly a franchising matter, attached as a separate item you will find some important information that may have an impact on your costs of doing business in Ontario, as received by us recently from Canadian counsel with whom we regularly work.

In broad summary, approximately 50% of the costs of various recycling programs will be passed on to companies who “introduce” materials subject to recycling into Ontario. The attachment details the process involved and the materials to be covered. Moreover, if you are affected, there may be an opportunity to pass on the costs of compliance to your franchisees in Ontario.

For further information, please contact us or Markus Cohen Q.C. LL.M., Suite 1010, 22 St. Clair Avenue East, Toronto, Ontario, Canada M4T Tel: 416.961.7011, Mobile: 416.301.9102. ■

CALIFORNIA DEPARTMENT OF CORPORATIONS REQUESTS INPUT RE “CUSTOMER SATISFACTION”

Contrary to popular impression, state government officials, at least at the highest levels, do care about the quality of the services they provide. As related to franchising, that’s probably most important in the area of state review of UFOC filings, including both initial filings, renewals, amendments and other submissions.

California has recently taken the lead among all of the states in the level of its commitment to rationalizing the review process.

This began last year when the State Bar Franchise Law Committee, with Lori Lofstrom as Co-Chair, significantly expanded its working relationship with the Department of Corporations and a substantially revised process (“risk-based review”) for reviewing franchise filings was initiated. That relationship has continued to expand through additional efforts this year, with David Holmes serving as Co-Chair of the State Bar Franchise Law Committee.

As part of that effort, the Department has asked us to remind Franchisors that the Department welcomes feedback from Franchisors about their experiences in the application process. Was your filing handled in a timely manner? Is there additional information you would like available on the Department’s website?

If you have comments you’d like to share with the Department, you can do so by completing a Customer Satisfaction Form available on the Department’s website: www.corp.ca.gov. If you’d be more comfortable submitting your comments and observations anonymously, please let us know and we’ll be glad to pass them along for you, keeping the name of the system involved confidential if you wish. ■

IS THERE A GAAP IN YOUR GAAS?: THE IMPACT OF REGULATORY CHANGE IN ONTARIO

By Markus Cohen, Q.C., LL.M

Although other objectives may be operative, financial audits are mainly concerned with providing reasonable assurance that financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles (GAAP). If two or more companies being studied state that they observe the same set of rules in *gathering* and in *presenting* their financial information, comparisons of reported results may be relied upon in judging which of those companies is faring “best.”

In most of the developed world, the

determination of GAAP is in the hands of either government agencies or self-governing bodies of accounting professionals.

For the U.S., GAAP applicable to non-governmental entities is enunciated by the Financial Accounting Standards Board (FASB), while the appropriate *auditing* standards are established by the American Institute of Certified Public Accountants (AICPA). In Canada, the analogous body is the Canadian Institute of Chartered Accountants (CICA), which establishes both GAAS and GAAP for Canada.

Financial disclosure is an important part of pre-sale franchise disclosure. If a franchisor does not qualify for exemption from financial information disclosure under Ontario’s Arthur Wishart Act (*Franchise Disclosure*), 2000 (the “Wishart Act”), then the regulations under the Wishart Act mandate attachment of a set of financial statements that meet specified criteria to a disclosure document if that document is to be considered complete.

Moreover, reliable comparisons of two or more sets of financial data are only possible when the reader has reasonable

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comfort that substantially the same approach has been taken by disparate professionals in the *gathering* (i.e., application of auditing standards) and *presentation* (i.e., application of accounting principles) of the data.

It follows that there must be an identifiable and reliable framework for the gathering of such data. The *gathering* framework is GAAS. Then, there must be an identifiable and reliable framework for the presentation of such data. The *presentation* framework is GAAP. If there are material differences in the respective standards and principles generally and consistently applied between professionals in the U.S. and in Canada, it will not be possible—in the absence of a clear understanding of those differences—to make reliable comparisons between two sets of financial data. In other words: If I cannot by reason of application of either different standards or principles—or both—determine which of two competing franchise systems is “doing better” financially, I may be denied an objectively wise investment decision between them.

The franchisor making disclosure under Ontario law is entitled to exhibit either audited financial statements or statements prepared pursuant to a review engagement. Only review engagement statements expressly require observance of the rules for such engagements that are set out in the *CICA Handbook*. As this is written, the currently-effective audited statement requirements are silent as to the rules to be observed, leaving the issue an open question. Many practitioners surmised that since the regulations expressly applied the *CICA Handbook* in only one of two potentially-applicable situations, that the *CICA Handbook* did not necessarily apply in the other situation: this surmise is based upon the Latin maxim - *expressio unius est exclusio alterius* which means “to express one thing implies the exclusion of the other.” Most especially, the prevailing view was that a set of audited financial statements which applied either CICA or AICPA rules would satisfy the disclosure regulations. But this position was never really free from doubt and may yet be determined by a competent court to have been wrong. (The law never “is,” it’s always “about to be.”)

However, effective March 22, 2004,

the regulations will change to require those financial statements which are presented as “audited” to be prepared in accordance with generally accepted auditing standards (GAAS) as mandated by the *CICA Handbook*. There is no express reference to GAAP, but Canadian accountants will tell you that the application of Canadian GAAP is necessarily implied by GAAS which dictate that the auditor’s report in such a case will make reference to Canadian GAAP. This change is rightly perceived as further impeding non-Canadian franchisors from effectively making acceptable financial disclosure by simply appending financial statements which bear a U.S.-based auditor’s report since such home-produced statements will almost invariably have been produced in accordance with U.S. GAAP following the application of U.S. GAAS.

Adherence to a common set of auditing standards is designed to ensure credibility of the results embodied in the financial statements thus created. The reader is encouraged by the auditor’s report referring to GAAS to have a high degree of confidence in the fair presentation of the financial results which in turn have reportedly been prepared in accordance with “GAAP.” Since there are at least some material differences between U.S. and Canadian GAAP, it is important for readers to know whether such material differences are actually in play regarding the specific set of financial statements being examined. Such differences in GAAP may arise out of differing national treatment of such things as amortization (useful life of assets) and depreciation (a tax concept), timing of income recognition and inventory evaluation. The first two items have impact on the income statement; the latter is a balance sheet item.

GAAS universally exhibits the following elements: (a) independence (including avoidance of personal and other impairments such as (i) a close family relationship with an officer or director of, or (ii) an investment in, the audited entity), (b) exercise of reasonable care and diligence (i.e., the application of sound professional judgment), (c) adequate professional competence, (d) appropriate quality

control and assurance, etc. In these respects, U.S. and Canadian GAAS are virtually identical.

Importantly in the context of this article, adherence to reporting standards require the auditor to state whether the financial statements have been prepared in accordance with GAAP, whether such principles have or have not been consistently applied and-if not-in what respects, and whether GAAS was observed. And the auditor must express an opinion on those statements as part of his report. That opinion may be qualified or unqualified. If qualified, the particulars of the qualification must be set out.

Some non-Canadian companies report that it may be very expensive to have their audited statements vetted by Canadian auditors simply to ascertain the differences, if any, between Canadian and U.S. GAAP for the purposes of its statement presentation. If they choose to avoid the expense and not obtain that particular service, they will (a) not begin to qualify for exemption from disclosure of their financial statements in Ontario, and (b) will have to tailor the text of the related disclosure paragraph to warn readers of the absence of adherence to Canadian GAAS and GAAP to the extent that the differences may be material. If that approach is taken, then perhaps at worst they will face a 60-day rescission right being exercised by a franchisee who relied on such financial statements as part of the decision to enter into the purchase transaction. On the other hand, to the extent that the failure to apply Canadian GAAS or GAAP resulted in a material misrepresentation, the franchisor could also face an action for damages arising from such misrepresentation.

For consultation and advice on meeting the challenges presented by the forthcoming regulatory change, please contact the author either via e-mail or telephone him toll free at 1-877-413-6482.

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A VIEW FROM THE BRIDGE — A DECADE OF GROWTH:

Lessons Learned from the Transformation in Franchising

Peter M. Birkeland

Peter Birkeland was recently a guest speaker at two of the International Franchise Association Franchise Business Network Meetings which Holmes & Lofstrom sponsors. His insights, drawn partly from the academic world and related research, on franchising were fascinating, sparked extended discussion at our meetings and we asked him if he'd provide us with a related article for our newsletter readers. He graciously agreed to do so, the result is presented below and we definitely recommend that you review it.

More information can be obtained from Peter at peter@birkelandinstitute.com.

Executive Summary

Our research indicates a significant transformation is underway that not only impacts franchisers and franchisees, but also has implications for executives and managers in non-franchised businesses. Those leaders who are able to grasp the changes underway and catalyze their companies to take advantage of them will not only increase performance in the short-term, but will create value for all stakeholders in the long-term.

Some business revolutions have a definite starting point; others begin with a series of small changes that oftentimes go unnoticed but accumulate to create a new paradigm. Over the past decade franchise companies have experienced an accumulation of incremental changes that now impact them in significant ways.

What is the transformation underway in franchising? What best practices of franchisers and franchisees enable them to win? And what sources of competitive advantage can you use to position your company to out-perform others? This is the first of a three-part series exploring the changing nature of franchising and tactics companies are using to out-perform others.

Our methodology for understanding the transformation in franchising is straightforward. We refer to research I conducted for my book, *Franchising Dreams*, to develop a factual and empirical baseline of franchising a decade ago. As part of that research I worked in the front-line operations and also with major franchisers. Based upon that earlier work we identified five changes that are beginning to shape the future of franchising, summarized in the chart below.

Transformation in Franchising	
1993	2003
Win-lose relationship between franchisers and franchisees	Win-win relationship between franchisers and franchisees
Franchiser motivation: Control the system	Franchiser motivation: Create profit and growth
Franchise business model applied to national market with traditional franchisees	Franchise business model applied to global markets with non-traditional franchisees
Franchisees own a single-unit, operate under single brand	Franchisees own multiple units, operate under multiple brands
Franchisee motivation to buy a franchise: steady income	Franchisee motivation to buy a franchise: Investment opportunity

Change 1: From Win-Lose to Win-Win

Academics say that the trademark is the “cornerstone” of franchising, but for most franchisers and franchisees the trademark is secondary to the relationship both parties have to each other. Ten years ago a win-lose framework predominated franchising. Franchisers controlled franchisees through a one-sided contract or through heavy-handed management

techniques. Franchisees countered by ignoring the franchiser, by forming councils to circumvent the franchiser, or by litigation.

Today the best practice is to develop a win-win framework. States Russ Reynolds, CEO of Batteries Plus, “Franchising is a lot about conflict, a lot about constructive tension. We've learned that we have to agree to disagree sometimes, but the important thing is to keep a clear vision and try

to advance that.”

One manifestation of a win-win framework is that disputes are more often resolved through mediation rather than litigation. “Litigation breaks down the franchise relationship,” states Nancy Weingartner, editor of Franchise Times, “but with mediation it's more of a problem solving opportunity that allows you to end up with a stronger relationship.”

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Change 2: Franchiser Focus in Creating Profit and Growth

A decade ago one of the overriding goals of franchise companies was enforcement of system standards. As a CEO of a Fortune 500 company noted, "A manager will do what you want but won't work hard; a franchisee will work hard but won't do what you want." Since franchisees are typically dispersed across large regions field support staff were employed to ensure that franchisees followed the methods and practices of the franchiser and kept the trademark value high.

Today the most pressing need for most franchise companies is to provide growth opportunities to franchisees. Ken Walker, President and CEO of Meineke stated, "We've learned that to be successful at franchising we have to keep the company's ego in check because it's all about franchisees and making them successful, not about the franchiser." Chad Hallock, president of Budget Blinds concurs. "The difficult part about being a franchiser is making sure that one plus one equals three. If you're not doing that then you're not adding value and you shouldn't be in the franchise business."

Change 3: Franchiser Business Model Becomes More Complex

Compared to a decade ago, franchiser business models have become more complex due to technology, globalization, and emerging domestic markets. Like most companies franchisers have had to assess the magnitude and breadth of technology on all employees, and measure both the true cost and benefits. Beyond this, however, technology has impacted a franchiser's ability to generate leads. As Greg Tanner of Quiznos notes, "We get about 16,000 leads every quarter and can only sell a fraction of that. Even though we're selling a franchise every 4 hours and opening a store every 16 hours, our biggest challenge is qualifying all the people that contact us."

Ten years ago franchisees were largely similar across a range of characteristics and franchisers could manage franchisees with a one-size-fits-all approach and be effective. But as franchisers expand globally they must deal with people from different cultures, backgrounds, and with different values. Today franchisees are more diverse and a one-size-fits-all

approach spells disaster.

Compared to ten years ago, franchisers are exploiting non-traditional markets more effectively. According to C. Everett Wallace, director of the National Minority Franchising Initiative, some franchisers are focusing on emerging domestic markets rather than global markets. "Many companies are realizing that there is a lot of growth in markets that have been traditionally underserved and neglected-and they're right here in our backyard. Urban markets have a high density population, speak our language, use our currency, and share our values."

Change 4: Franchisee Business Model Becomes Complex

The franchisee business model has also become more complex as franchisees own multiple units and operate under multiple trademarks. Ten years ago most franchisees operated units within a single brand, and their business model was fairly simple: Learn the business and follow the system. Today some franchisees operate two brands in the same location, such as a McDonald's in a Mobil gas station, or a Dunkin' Donuts with a Baskin Robbins 31 Flavors.

Others, such as Charles Smithgall of Aaron's, own multiple units. Smithgall currently has 43 stores with plans to own 100 by 2008. And Carrols Corporation, the largest Burger King franchisee, currently owns 355 restaurants, has over 16,000 employees and revenues over \$650 million.

Finally, some franchisees own multiple units in multiple systems. Joe Cody, for example, is a franchisee with the Old Chicago chain, but also operates restaurants in five other systems as well as several restaurants of his own. "Some franchisers don't like the fact that we're so diversified," he states. "They'd like allegiance to just their system. But there are a lot of benefits in being involved with different systems. You not only spread your risk, but you learn a lot more."

Change 5: Shift in Franchisee Motivations

A final transformation in franchising involves the motivation for people to buy a franchise unit. Ten years ago people bought franchises for primarily two reasons: either because they were pursuing the "American Dream" of owning their own business, or because

they wanted the security of a franchise. Today the motivation is not so much the American dream or security, but the expected financial returns.

Consequently today's franchisees are more sophisticated, more knowledgeable about business, more likely to have significant business experience, and more often have an advanced degree such as an MBA, compared to franchisees ten years ago. Companies have responded by providing full and accurate information on expected returns. In the past potential franchisees had to discover the financial returns but today the best practice of leading companies such as Aarons, Jimmy Johns Gourmet Sandwich Shop, or McDonald's, is to provide prospective franchisees with financial data on overall revenues, breakeven, and operating expenses.

The Challenge

In the early 1990's franchise companies could win with a relatively formulaic approach to the business: Write an iron-clad agreement, sell as many units as possible to saturate the market, and approach franchisees in a one-size-fits-all manner. Today that formula doesn't work as well. Franchiser and franchisee business models are more complex, franchisees are more diverse and sophisticated, and the most successful companies focus on creating win-win relationships and profitable franchisees.

We believe that those companies that are able to think strategically about how to compete given the transformational changes, those that are able to manage both their distribution and supply channels, and those that are able to add value to franchisees will reap the rewards of long-term growth. The next issue of **View from the Bridge** will bring to light those companies that are best-in-class in managing the transformation.

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