FRANCHISE LAW INSIDER™

A Publication Reviewing Recent Franchise and Related Business Developments *3rd Quarter 2004*

"There are no shortcuts to any place worth going."
– Unknown –

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Holmes & Lofstrom's Quarterly I.F.A. Meetings

October 20, 2004
California's New Franchise Laws

Locations:
Orange County Breakfast
Karl Strauss Restaurant & Brewery
901 South Coast Drive
Costa Mesa, California 92626
7:30 am

San Diego Dinner
1141 Luneta Drive
Del Mar, California 92014
6:00 pm

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TRAINING: THE HIDDEN PROFIT CENTER

By: Mary Ann O'Connell, O'Connell & Co., Inc.

No matter where you look or what you read, we are in tough economic times and cuts need to be made to shore up our businesses. To make those cuts we look to the balance sheet and determine what departments are not profitable. Invariably, the Training Department falls into that category.

Though some training departments generate a few training fees, most companies cannot see a direct return on their training investment, so they cut – too deeply. No money is allotted to expand or improve course curricula, staff is pared and every corner is cut. In some cases the department is completely dismantled. Why not? Training doesn't pay.

Or does it? What are the pay offs to a good franchise organization that is trying to be conservative in these tough economic times?

The Customer

No matter what the business or the business format: customer satisfaction should drive the business decisions. A business needs to create and keep more and more customers in order to remain viable. So, what does that have to do with training?

Your brand is protected, and the customer experience is enhanced when the employees are well trained on what to do and how to do it well. When an employee knows the job well, then he can elaborate and make more of a statement for the customers.

An exceptional service experience creates a sense of value for the customer. They too are making their way and decisions with the same economic concerns that are affecting your business and are going to be selective about where they will spend their money. If they have a good experience they will become loyal customers. Retained customers are less expensive and create a greater ROI than do new ones. So, train your people and the customers will increase your profits.

The Prospective Franchisee

Franchising is a very competitive field these days and you need to seize every advantage that you can. A well-crafted training program can allay the fears of those who will enter your system with no industry experience. They will have confidence that you will help protect their investment by educating them well. This can often close the sale for you.

The Employee

Employee turnover is costly; it is expensive for the franchisees, alienates customers and slows growth. More employees leave their jobs because they don't like what they are doing than leave because of money. A leading cause of employee

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FRANCHISE LAW INSIDER™

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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frustration is that they don't know what is expected of them so they are bound to disappoint their employers and fail themselves. Rather than face that, they leave.

By creating a training program that can be delivered to your franchisees' employees you can increase employee retention, thus promoting sales growth in the unit all while protecting your brand. Franchisees will have fewer complaints when the business is growing. Also consider this: most franchisees are not skilled at training and therefore will try to avoid it. If you provide the training for them, the job gets done well and the profits can flow.

The Franchisor

We have already discussed how training can increase profits by getting and keeping more customers, and employees. What does that mean for you and the franchisee? It means a great return on your investments.

Franchisees that are profitable are less likely to exit the system or complain about it. You can eliminate the need for either of those strategies by choosing not to skimp on the training. Remember with training we can increase the average unit volume of each unit by increasing customer loyalty and that puts more money in the franchisees' pockets. With this increased cash flow, you will have lower accounts receivable and increased cash flow, as franchisees are able to pay their royalties.

Training a franchisee on all aspects of your business will have the same effect as having well-trained employees. A franchisee that knows how to operate well will have more confidence and should reach profitability sooner. So, the business will grow faster and your revenue stream will increase quicker. Additionally, when the franchisees are trained well, they require less ongoing support and you can save costs on field support staff.

There will be less franchisee turnover, fewer closed units, and system expansion as profitable franchisees open more additional units. When it all comes together, the customer and the employee that had a great experience with your brand may become franchisees themselves.

Now it is time to tally the profits from the department with no revenue stream:

Let's assume your franchise fees are $25,000, an average unit has $300,000 in sales and the royalties are 7% of sales. The average customer is worth $100 per year. So,

1 customer that is retained for the 10 years of the agreement =	$ 1,000
1 additional store opened by an existing franchisee =	$ 25,000
1 royalties from that store ($300K x 7%x 10 yrs)=	$210,000
1 new franchisee=	$ 25,000
Royalties from the life of the average store =	$210,000
1 store sales increase of 5% (@7% royalty)=	$ 22,050
For a conservative return of =	**$493,050**.

Multiply those returns by the number of units in your system and the returns are huge! This is not a place to use your pruning shears, it's a place to grab a shovel and get all the profits.

So when times are hard and things need to be cut, look away. If trained well, what can the franchisees do for themselves? What will they need less that can be trimmed from the budget? Look there and rely on a good educational base on which to build the business.

Mary Ann O'Connell is the principal consultant with O'Connell and Company, Franchise Advisors. She has 25 years experience in franchise operations and training as a franchisee, franchisor and consultant. For more information call 714.434.1516. www.oconnellco.com, maryann@oconnellco.com

Top 10 Things Franchisors Do Wrong

By: Lynne Anderson

Numbers 1, 2 and 3 (in bold) are the top 3 mistakes most often seen in franchising, are not state specific, and generally result in increased legal expenses, possible loss of existing franchisees and sometimes fines paid to a state.

1. **Failure to maintain copy of current UFOC**
2. **Failure to re-disclose prospects in pipeline when the UFOC is undergoing material revisions**
3. **Unregistered franchise sales**
4. Failure to report negotiated sales in California
5. Illegal/unregistered earnings claims
6. Offers/Sales on documents before amendments have been filed/approved
7. Marketing/advertising in states in which the franchisor is not currently registered
8. Using advertising/marketing materials not currently on file with a state the franchisor is registered in
9. Franchisor fails to inform legal counsel of material changes (e.g. oops we have had a new president now for 6 months and didn't tell you!)
10. Not keeping accurate records of information for Item 20 ■

Gaining Support For A National Advertising Fund

By: Allison Hoffman, SVP/Partner, Empower MediaMarketing

One of the great marketing challenges facing franchisors with locations in many markets across the country is the implementation of a national advertising fund that attains solid support and buy-in from a wide cross-section of franchisees. In theory, such a fund should easily generate an enthusiastic thumbs up; after all, national advertising support for the brand is clearly beneficial to local operators. The reality is frequently quite different, however, as franchisees often feel resentment over a national media plan that exhibits – in their opinion – a lack of understanding of the particulars of their own unique markets.

Given the diversity of markets and franchisee marketing needs, is it possible for franchisors to implement a national advertising fund that actually attains unanimous approval from franchisees? The answer is "yes," provided that certain actions are taken.

Action One:

Set up a meeting with franchisees to talk about the fund and how it will be deployed. Open discussion is the first step toward giving franchisees a sense of ownership of the program and, ultimately, attaining their support for it.

Action Two:

At the franchisee meeting, bring in your third-party media planning & buying agency to explain how the media plan will be developed. This is perhaps the most critical element of the buy-in process, since the localism aspect is often the major objection franchisees raise when speaking out against a national fund. It is important for franchisees to have an opportunity to interact and share views/concerns with the media agency. It is also extremely important that the media agency explain to franchisees that a "national" ad campaign does not have to mean one size fits all. The effort would be a "spot" campaign, which means that media plans will be developed on a market-by-market basis, depending on local needs (more on this in a moment) and issues.

Action Three:

Make sure the agency talks about all the considerations that will go into developing the media plan. This discussion should begin with an overview of the media landscape. It is important for franchisees to fully understand the myriad media opportunities that are available to reach the target audience. Today's consumer is bombarded by more than 5,000 message a day, making selection of the right media mix an absolutely critical element – along with creative execution – in breaking through the wall of clutter.

Another important part of this discussion is that of the target audience. The media agency should use market research to paint a picture of the business's prime prospects. This research should look at demographic and psychographic components such as income, level of education, home ownership, professional status, age, marital status and other defining characteristics that make up the target customer.

Action Four:

Following a discussion of considerations that go into the development of the media plan, the agency should provide an overview of the media consumption habits of the target market. And, within each media group, specific options should be cited. For example, if research shows the target market to be heavy users of radio, to which radio formats do they most frequently listen? News/talk? Classical? Adult contemporary? Classic rock? Ethnic? There are many possibilities.

Action Five:

Hopefully, by this point, the franchisee audience will understand that the media agency put a lot of time and effort into understanding the business's prime prospects and how to reach them. But, this still leaves open the issue of

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localism and the fact that there are differences from market to market in terms of media usage patterns. In some markets, for example, people spend more time in their cars versus people; in other markets, perhaps making outdoor advertising more attractive. Other markets might have a particularly high daily newspaper readership, while others might show heavier usage of, say, news/talk radio.

It would be helpful for the agency to show media plans for two specific markets; ideally, two markets that are different in their make-up so that franchisees can see that their specific needs will be understood and addressed.

Action Six:

Finally, the agency should talk about the plan's objectives and ways that results will be measured on a market by market basis.

When asked to contribute to a national ad fund, franchisees are concerned primarily about what kind of return they will get on their investment—and rightfully so. The six action steps cited above represent an effective way to help assuage these concerns by shedding light on the entire process, from media plan development to results measurement.

Allison Hoffman is the SVP/Partner at Empower MediaMarketing in Cincinnati, Ohio. For questions or more information please call 513. 719.6214.

Corporate "Tips and Traps" in California

By: Lori M. Lofstrom & Peggy Karavanich

We are often called upon to assist clients in the formation of their new business entity. Whether for an "emerging" franchisor client or general business client, most of the basic formation issues are the same. To remind readers of the basic requirements that can get pushed aside and forgotten due to the stresses and strains of starting a new business, especially a new franchisor entity, we thought we'd provide an overview of California corporate formation principles, many of which are similar to those of other states.

Formation Issues

A corporation's existence begins on the date the Articles of Incorporation are filed with the Secretary of State. We call this the corporation's "birthdate". The entity is not able to do business or enter into transactions prior to this date as it does not yet "exist". Prior to filing the Articles, it is advisable to verify that the name is available. In the State of California, it is possible to reserve a name in advance of filing Articles for 60 days. Until the Articles are filed or the name is reserved, it is not advisable to print business stationary, cards or promotional materials, or pay for extensive graphic design services. If a logo or unique name is used, it is also a good idea to order a trademark search to determine other, prior usage that may conflict.

Statement of Information

The initial Statement of Information is due within 90 days of corporate formation, and annually thereafter, although this has varied in recent years from bi-annual to annual in California, so do check for the most current requirements. The filing fee is currently only $25.00, but failure to file this simple form can subject the corporation to penalties and late fees starting at $250 assessed by the Secretary of State and Franchise Tax Board, as well as possible suspension of the corporation's status.

Securities Law Filing

California law requires that a form be filed with the Department of Corporations, even when a small business corporation issues shares to a very limited group of individuals. Failure to timely file this Notice of Transaction regarding the issuance of stock with the Department of Corporations within 15 days of issuing stock may subject your corporation to additional fees and penalties.

Annual Tax Return

With the exception of banks and financial corporations, every corporation that is doing business in California not expressly exempted, is required to file an annual tax return with the Franchise Tax Board and pay a minimum annual franchise (or state) tax of at least $800.00. Failure to file an annual tax return and pay the required tax will result in suspension of corporate powers, rights, and privileges, as well as penalties and interest. We recommend that you work with a CPA experienced with business accounting and tax matters.

Failure to Maintain Adequate Minutes or Records

Holding annual meetings of shareholders and directors is one of the formalities of corporate existence that must be followed. Many corporations go for years without updating the minutes of their annual meetings. Just as failure to follow proper procedures in forming a corporation may lead to a defectively formed corporation, failure to observe corporate formalities, including maintaining adequate books and records may cause fatal defects, resulting in the loss of the advantages of incorporating in the first place, and may ultimately subject the principals of the corporation to personal liability for the debts and obligations of the corporation. Additionally, holding annual meetings allows the corporate shareholders and directors to meet on a regular basis to discuss problems and communicate with one another about areas of concern.

Undercapitalization of Corporation

The incorporator must be prepared to transfer money or other assets into the bank accounts of a new corporation because shares of stock can only be issued for valuable consideration. Under some circumstances, failure to capitalize the corporation adequately at its inception may permit creditors of the corporation to "pierce the corporate

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veil", rendering the shareholders personally liable for the debts of the corporation and defeating the primary reason for incorporating in the first place.

Failure to Maintain Arm's-Length Relationship Among Related Entities; Commingling of Funds

Failure to maintain an "arm's length" relationship among the corporation, its principals and other related entities can also cause a court to declare that the separation between the corporation and its stockholders fails to exist. To maintain separateness, all loans to or from the corporation should be documented with appropriate corporate resolutions and promissory notes. Contracts, leases, license agreements and other transactions between the corporation and its shareholders or affiliated companies should likewise be properly documented. Relevant provisions of state law need to be consulted regarding any principal's ability to vote when they may have an interest in the transaction.

Foreign Qualification

Generally, a corporation chartered in one state must "qualify" to do business as a foreign corporation in another state where it intends to do business. Most qualification statutes also require the filing of a document similar to California's Statement of Information, along with a filing fee and the designation of a resident agent for service of process within the state. States usually require a current Certificate of "Good Standing" from the state where the corporation is domiciled in order to process an application to qualify to do business as a foreign corporation. In California, foreign corporations doing business within the state that fail to register with California are subject to a $20 per day penalty, as well as a penalty of $250.00 payable to the Secretary of State.

Delegation of Authority/ Appropriate Documentation

While major decisions such as electing and removing directors, amending the Articles of Incorporation and Bylaws and the sale of all or substantially all of the corporation's assets usually require shareholder approval; the board of directors may make financial decisions such as deciding whether to mortgage, sell or lease real estate, approve loans to or from the corporation and enter into various contractual agreements, and may authorize the elected officers to carry out the day-to-day business of the corporation. However, important corporate decisions such as these should be agreed upon and properly documented with appropriate resolutions, to protect a corporation's limited liability status. Keeping good corporate records of the approval and ratification of critical decisions may head off controversy and dissension within your ranks in the future, as well as to ensure that you are able to produce solid documentation if key decisions are later questioned by creditors, the courts or the IRS.

Misrepresentation of the Ownership, Management and Financial Interests

Any director, officer or agent of a corporation who knowingly misrepresents the value of the corporation's business operations, profits or losses, or issues an untrue or exaggerated report or statement which contains any material false information or omission intended to give the shares of stock a materially greater or less market value is guilty of a felony, and subjects the corporation to civil penalties, and payment of fines and penalties up to One Million Dollars in California. Likewise, any director or officer who willfully issues or consents to the issuance of stock certificates with the intent to defraud present or future shareholders is guilty of a misdemeanor, punishable in California by imprisonment and/ or a fine or both.

In summary, while these steps are relatively simple, it is easy to miss one or more requirements and subject you or your corporation to some serious consequences. It is important to assemble and keep available the legal, accounting, tax and general business advisors to help you in these areas and allow you to focus on running and growing your business. ■

Franchise Legal Update

Important New California Franchise Legislation

Earlier this year, the California State Bar Franchise Law Committee, co-chaired by Holmes & Lofstrom's very own David Holmes, drafted important pending legislation that significantly changes the California Franchise Investment Law.

This franchising bill, known informally as the "2004 Franchising Omnibus Bill", (AB.2921) was introduced earlier this year and has since been amended and approved by the California Assembly and Senate. On September 10, 2004, it was signed by the Governor.

With input and support from the Department of Corporations (the "DoC,") and spearheaded by Timothy LeBas, Deputy Commissioner and General Counsel for the Office of Law and Legislation, that legislation has now been fully approved. We wanted to share with you an advance look at some of its main features.

The bill represents a wide-ranging consensus reached between representatives of Franchisors, Franchisees and the DoC. In general, the new law should make life easier for Franchisors doing business in California.

The main provisions are as follows:

• The Bill confirms that the DoC will continue a "risk-based" process of reviewing franchise applications. This means that the DoC will review application information that poses the most risk to prospective franchisees, including risks associated with the franchisor's financial condition, the franchisor's compliance record and deficiencies with the franchisor's application. The DoC should,

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therefore, spend less time concentrating on grammar and other minor issues in filings, and devote more resources to enforcement.

• The Bill also provides specific exemptions from registration for offerings to sophisticated franchisees and amends provisions related to negotiated sales transactions, including removal of the requirement for placement of information in the UFOC regarding past negotiated sales.

• Amendments will also allow UFOCs to be delivered electronically (as already allowed by the FTC in some circumstances) via Internet, Zip® disk or otherwise, the details to be worked out in later regulations to be adopted by the DoC and in which Holmes & Lofstrom expects to have input.

• The proposal amends the provisions regarding material modification of an existing franchise, removing the requirement for a filing with the DoC in many instances.

• Additionally, the bill amends the enforcement provisions of the law, giving the DoC expanded powers, and increases the fines for violations, in some cases by substantial amounts.

• The Bill exempts certain "Franchise Loans" from the California Finance Lenders Law to resolve an outstanding issue of concern at the DoC of late, and to allow Franchisors to continue to offer Franchisee-favorable financing without complying with extensive regulatory requirements.

• Those parts of the bill relating to franchise loans took effect on the Governor's signature, with remaining parts coming into effect on January 1, 2005. Further details are available at www.HolmesLofstrom.com.

Class Action/Legal Reform

IFA supports class action reform legislation that amends the procedures that apply to consideration of interstate class actions to ensure fairer outcomes for class members and defendants. One of the main goals of the legislation is to allow large, multi-state class action suits to be moved to federal court to ease overburdened state courts and to ensure that uniform standards are applied to interstate class action litigation. IFA is an active participant in the "Litigation Fairness Campaign" sponsored by the U.S. Chamber Institute for Legal Reform to aggressively promote class action and other legal reform.

The House passed "the Class Action Fairness Act," H.R. 1115, in 2003, and late last year, it was announced that a deal had been reached with enough Democrats to ensure passage of the Senate version despite a filibuster threat. The Senate briefly considered a new version of class action reform, S. 2062, The Class Action Fairness Act of 2004, but withdrew it for procedural reasons. It is unlikely to be considered again in 2004.

Veterans in Franchising Programs

Congressman Henry Brown (R-SC) has proposed the Veteran's Self Employment Act of 2004, which would allow veterans, members of the Selected Reserve, survivors and dependents to use up to one-third of their educational assistance benefits toward the costs associated with the purchase of a franchise, as long as the company sponsor provides training to the new franchise owner. While this bill has not yet been introduced, the IFA has committed to working with Rep. Brown to advance this important legislation.

On June 16, IFA's Vice President of Government Relations, John Gay, delivered testimony concerning the Veteran's Self Employment Act of 2004 before the House Committee on Veterans' Affairs Subcommittee on Benefits. Accompanying John, to provide technical expertise about franchise training programs was former IFA Chairman, Jim Amos, Managing Partner of Eagle Alliance Partners and Chairman Emeritus of Mail Boxes Etc.

SBA 7(a) Loan Program Legislation

In early February, IFA sent letters to the Bush administration and to members of the House and Senate Small Business Committees asking them to support full funding for the SBA's popular 7(a) loan program for FY 2004. Until recently, the program was operating on $9.4 billion dollars and needed another $3 billion to meet this year's demand for loans and avoid a shutdown. Because of the funding shortfall, SBA suspended the program in January, then reinstated the program, capped its 7(a) loans at $750,000 and placed other restrictions on how the loans may be structured. In its letter, the IFA also asked recipients to support lifting these restrictions.

In early April, Congress passed H.R. 4062 to shore up FY 2004 funding to avoid a 7(a) program shut-down later in the year. IFA signed an Access to Capitol Coalition letter earlier in March in support of a similar bill. On July 6th, the Access to Capitol Coalition secured an additional $79 million for the program in FY 2005, via an amendment offered by Small Business Committee Chairman and Ranking Member Donald Manzullo (R-IL) and Nydia Velasquez (D-NY). If this appropriation makes through the entire process, which is still very uncertain, there would be roughly $14 billion available for 7(a) next year because the 2004 fee increases will be extended. Again, however, this language still needs to get through the Senate process.

Obesity Legislation

Rep. Ric Keller (R-FL) introduced H.R. 339, the "Personal Responsibility in Food Consumption Act" which would prohibit frivolous lawsuits against food distributors and restaurants. Sen. Mitch McConnell (R-KY) sponsored S.1428 that is similar to the Keller measure. A hearing on H.R. 339 was held in June, 2003 in the House Judiciary Commercial and Administrative Law Subcommittee.

On March 10, the House approved H.R. 339 by a vote of 276-139. The legislation now moves to the Senate where the coalition hopes to capitalize on the strong House vote.

Minimum Wage

The current federal minimum wage is $5.15 an hour and was last raised in September of 1997. Senator Edward Kennedy (D-MA) has vowed to offer his proposal to increase the minimum wage by $1.85 per hour over two years as an amendment to any number of unrelated bills, including class action

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reform, which may provide a means for moving the issue forward. In early July, IFA asked all members to write their Senators in support of class action reform and opposition to any minimum wage amendments. IFA and other members of the Coalition for Job Opportunities will continue to oppose this proposal. Senator Kennedy has also introduced a new version of this legislation – S. 2370.

In California, legislature is considering a bill to make changes to the California Franchise Investment Law (AB 2921). IFA is working with the Department of Corporations and the California Bar Association's Franchise Law subcommittee in support of the legislation, which includes a provision to exempt franchised businesses from the California Finance Lender's Law. This bill passed the Assembly and has passed both the Senate Commerce and Judiciary Committees. It must make one more stop in the Senate Appropriations Committee before it goes to the floor in August for final passage.

Another California based issue of concern to IFA members is the health care tax (SB 2). There is a campaign underway, which IFA is supporting, to repeal this law on the November ballot. This California law also has national implications, as a number of states have considered bills that are similarly structured.

The majority of legislative activity that impacts the franchising community in 2004 is in the tax arena and the IFA has responded to this challenge by re-establishing its Tax Information Network to advise the Legislative Action Group (LAG) on the establishment of IFA policy positions on important tax matters and drafting talking points to be distributed to member lobbyists and state legislators. This group has met several times via conference call and has finalized holding company talking points. IFA has also visited Virginia twice this session – once to specifically educate lawmakers about these issues. The IFA has also lobbied this issue in Texas during this year's special legislative session concerning public school finance.

Regulatory Activity
Federal Trade Commission Franchise Rule

The morning of August 25, 2004, the FTC released its Staff Report on the new Franchise Rule which has been 10 years in the making. The rule has not yet been approved, and the commission is accepting comments from the public until November 12, 2004.

Financial Accounting Standards Board Interpretation of Consolidation of Variable Interest Entities – FIN 46

As a reaction to the Enron scandal and as directed by Congress, the Financial Accounting Standards Board (FASB) has published Interpretation No. 46 "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51". Referred to as FIN 46, the interpretation sought to capture on a company's financial statements the type of shadowy financial entities used by Enron. In doing so, unfortunately, the new standard also captured the standard franchise relationship.

The IFA responded to this serious threat by forming a working group of members, enlisting the expertise of its outside counsel, and hiring additional outside counsel with Securities and Exchange Commission (SEC) expertise. IFA has met with the staff of FASB and the SEC expressing concerns about the matter and requesting a clarification of the inapplicability of FIN 46 to franchise relationships and proposing the immediate suspension of the application pending the issuance of a clarifying statement from FASB. We also provided a lengthy analysis and other materials explaining the potential impact of FIN 46 on our members.

On November 12, 2003, the Subcommittee on Securities and Investment held a hearing on "The Financial Accounting Standards Board and Small Business Growth." Peter Salg, a Wendy's franchisee, testified on behalf of IFA and discussed FIN 46.

On December 24, 2003, the Financial Accounting Standards Board (FASB) issued "FASB Interpretation No. 46 (revised December 2003)" known as "FIN 46R." This release followed FASB board meetings on December 10 and 17 at which FIN 46 was discussed. The release of FIN 46R, the decisions made at those board meetings, as well as other actions by FASB, have given the franchise community reason to be optimistic that FIN 46 will not apply to the great majority of traditional, business format franchise relationships. There are still questions that must be addressed, but the IFA will continue to work with FASB staff, the Securities and Exchange Commission (SEC), Congress, and the large accounting firms to ensure a successful resolution of this issue.

DOL Overtime Regulations

On April 20, the Department of Labor (DOL) issued a final rule updating 50-year-old regulations defining exemptions from the Fair Labor Standards Act for white-collar employees. When these draft revisions were first released in the summer of 2003, the IFA and thousands of others filed comments.

The proposed changes should bring clarification to questions that frequently arise in the service sector regarding who qualifies for overtime, who is a professional, etc. The proposal revises job duties to comply with current business realities. Also as a result of the rule, a larger number of workers will automatically qualify for overtime.

IFA and other business groups support the new rule, but organized labor opposes the measure. In early May, the Senate voted to prevent the rule from taking effect, but it is unclear whether the House will follow suit.

SBA Size Standards Reform

Earlier this year, the SBA proposed a new rule to overhaul the standards it uses to determine whether or not a business is a small business for purposes of SBA programs. This proposal would have moved from a system that used both a company's receipts and numbers of employees to largely an employee numbers based system. IFA has significant concerns with this new rule, as did others in the businesses community. Finally, on July 2, the SBA withdrew this proposal. ■

Understanding What Motivates People

By: Herbert M. Greenberg, Ph.D., President and CEO of Caliper

Managers often ask themselves, "How do you motivate people?" Our answer is, "You don't."

When we delve below the surface, we have found that all effective managers share one thing in common: An ability to understand and focus on the inner motivations of themselves and of those around them. The key phrase here is "understand and focus on the inner motivations." In truth, managers cannot "motivate" others.

Motivational speakers, incentive plans and contests do not essentially change performance. They all miss the mark because they deal with the external rather than "internal motivations." Of course, people want promotions. They want the highest commissions they can receive. And they do not want to be fired. However, simply dangling these carrots does not create effective and consistently productive work.

The true motivation that causes individuals to excel comes from within. It is this inner motivation that distinguishes the twenty percent of those who succeed in virtually every profession. Effective managers have to uncover whether someone has the inner motivations needed to succeed in a particular position.

What motivates managers, salespeople and CSRs?

For starters, the most effective managers like to make decisions and take risks. They are consistent and fair, they command respect from others, and they are good communicators. They are able to gather information and analyze it in reference to the company's present and future needs. They know how to delegate projects. And they encourage growth in others as well as themselves. The most effective salespeople, on the other hand, possess very different qualities. They are able to understand what other people are thinking and feeling. They are motivated to turn others around to their point of view. And they are able to bounce back from rejection and seize the next opportunity.

Salespeople, unlike managers, want to be out there themselves, meeting prospects and clients, negotiating and closing deals. And the most successful customer service representatives bring a list of entirely different qualities to their jobs. They are motivated to please others, driven to come through, organized, detail oriented and able to relate well with others. They are not, like successful salespeople, overly motivated to persuade others.

Added to this, some people are motivated by security, others want control, some are driven by accomplishment, others seek involvement, some want to belong and others want to develop. Embracing on and acting upon this understanding of what motivates people (new hires or existing employees) is certainly more complicated to deal with than using a broad stroke, a "one-size fits all" approach. But how these motivations are responded to (or ignored) sets the tone for the entire organization.

These motivations are hard to uncover, because often the individuals themselves are unaware of what motivates them. For instance, while every successful salesperson is motivated by an internal need to persuade others, very few would say, "I want to sell, because I feel ten feet tall when someone else says 'yes' to me." Yet, that is precisely what occurs in a successful sales process.

It is these inner motivations, many of which we are not aware of, which impel us to action. The most effective managers we have worked with understand their own motivations so that they are better able to understand the motivations of those who they oversee. And they know that if an individual does not possess the proper motivations required to perform successfully in a specific job, all the training and incentives in the world will not make that individual highly productive.

How do you identify these motivating forces?

There are three approaches to surfacing these factors:

1. Behavioral Based Interviewing: Perhaps the most difficult, it relies upon the expertise of the interviewer to elicit feedback from the applicant. Using very specific and probing questions to get to these motivational forces, the most effective practitioners of this process have received extensive training in this approach and have had years of experience to refine their skills.

2. Personal Observation: When an individual is already on board as a member of the team, astute observers can simply pay attention to what motivation factors have the greatest impact on the individual.

3. Personality Assessment: A valid and legal personality test will routinely uncover this very important information so that it can be used to focus the new hire or existing employee appropriately.

Tapping into, understanding and focusing each individual's inner motivations is the surest way for managers to develop a productive work force. ■