OPINION

Looking deep into transfer cases

Author maintains franchisors can profit, don't purposefully

BY MARIO L. HERMAN

I take exception to the guest essay (by Lewis G. Rudnick) "Franchisors do not profit from transfers" (April).

If the question is, can franchisors profit from franchise transfers, then the answer is clearly yes.

If the question is, do franchisors purposefully establish a transfer department as a profit center, the answer is no. Most franchisors are not Machiavellian.

Franchisors set up transfer departments in response to the perceived need or inadequacy within their own system. Many transferring franchisees are charged a fee for this service, frequently not commensurate with the actual cost incurred by franchisors for the transfers. Franchisors also use the transfer process as an occasion to collect delinquent royalties out of escrow, and insist on "upgrades" to improve uniformity within the system.

Franchisors can also count on "new blood" in the system that generates working capital, a higher incidence of royalty payments and an improved attitude toward the corporation. (Transferring franchisees often have deteriorated relationships with their franchisors at the time of transfer and are many times delinquent in royalties.)

The alternatives to transfers, of course, are closures or independence.

Closures are bad for business and are to be avoided at all costs. Franchisees who take down their signs and go independent become competitors and may speak pejoratively about their former franchisors.

guest essay

Franchisees who close or go independent do not have a way to partially recoup their investment and they may not have signed mutual releases and nondisclosures with their former franchisors.

On the other hand, transferring franchisees may recoup a portion of their investment and are less likely to sue their franchisors because franchisors normally insist on mutual releases and nondisclosures as preconditions for approving transfers.

Franchisors also prefer to show transfers in their disclosure documents rather than closures or independents — it is easier to mask unprofitability within the system if you label unprofitable franchises as "transfers," and then proceed to provide innocuous reasons for the transfers ("bad managers," "wanted to retire," etc.). Given a choice between the three evils of transfers, closures and independence, guess which one franchisors prefer?

Finally, regarding the concern for lack of continuity when franchisees transfer, it is equally plausible that there will be no deterioration in the operations of transferred franchises. Frequently, the public is unaware that there has been a change in ownership.

Also, if the purchasing franchisees have bought the franchises at a discount, they may have a better chance of success since presumably they will not be saddled with enormous debt. (Remember the adage, "If you want a successful business, buy it out of its second bankruptcy.")

Yes, franchisors can profit from transfers. All too often, however, franchisees do not.

Your article on "Franchisor turnover raises questions" (February) was right on point, and Mr. Rudnick's attempts to pooh-pooh the article cannot go unchallenged. There are more than just a "few observers of franchising," as he put it, who would agree with the general implications of your article.

Why don't we ask the franchisees who have transferred over the last decade what they think?

Mario L. Herman is a Washington, D.C.-based attorney who specializes in representing franchisees.