

Franchising Outlook for 2009

By: Eric C. Perkins, Esq.¹

While the dim outlook for 2009 does not inspire much confidence for any sector of the economy, one can foresee a mix of opportunities and challenges in the world of franchising. Below are a few possibilities:

1. Greater Interest in Franchising. Increased unemployment and corporate downsizing will increase the population of potential franchisees. Unemployed individuals (and those anticipating being unemployed) may explore franchising more seriously as a career alternative. Franchisors might expect to see franchisee applicants in greater numbers and perhaps higher quality than in recent years.

2. Greater Concessions by Franchisors. Franchisors will employ more aggressive and creative sales methods in their efforts to recruit top quality franchisees which may take the form of lower fees, fee deferrals, and other forms of franchisor-provided financing. This is a period when prospective franchisees (at least those with adequate financing) arguably possess more bargaining power than in more robust economic times. Notably, Virginia is the only state that requires franchisors to meaningfully negotiate with prospects over most of the terms found in a franchise agreement.

3. Overall Contraction with Some Areas of Growth. According to a recent report prepared by PricewaterhouseCoopers for the International Franchise Association (IFA) Educational Foundation, overall franchised business growth slowed in 2008 and is likely to decline further in 2009—by an estimated 10,000 franchised units, 207,000 jobs, and \$4.2 billion in economic output. Notwithstanding these expected declines, franchising will remain an influential force in the U.S. economy, with over 850,000 franchised businesses employing 9.5 million people and generating more than \$800 billion in economic output. While representing slight decreases from 2008, it is important to note that these estimates for 2009 all represent increases over the corresponding figures from 2007. Further, certain business segments expect growth in 2009. According to a recent survey of industry leaders conducted by the IFA, the following industries are expected to enjoy the greatest growth in 2009: (i) home-based businesses, (ii) child-related businesses, and (iii) senior and healthcare-related franchise systems. In other business segments, expectations vary. For example, conventional wisdom suggests that auto repair businesses traditionally experience more growth during economic downturns, leading one to conclude that auto repair franchise systems might expect to perform relatively well in 2009 as consumers defer purchases of new automobiles in favor of squeezing another year out of their existing vehicles. However, the PWC report suggests otherwise—that very few industries (e.g., quick service and full service restaurants) are projected to experience growth in 2009.

4. Greater Leverage with Landlords. Some real estate industry experts predict the next phase of the current economic crisis will relate to an increase in commercial real estate loan

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defaults and foreclosures. With vacancy rates increasing at shopping centers and office buildings across the nation, franchisees should expect to have greater leverage with landlords when negotiating lease terms. This could mean greater tenant improvement allowances, multiple months of free rent, or other concessions.

5. The Credit Crunch Continues. Indications are that traditional bank financing will remain relatively inaccessible in 2009; therefore, prospective franchisees will need to be both diligent and creative in obtaining start-up financing. Expect to see franchisors make efforts to help prospects obtain financing, either through developing lending relationships and preferred lender lists for the benefit of prospective franchisees or perhaps by offering direct financing. Home equity lines may not be a viable source of capital given the decrease in home values across the country and heightened restrictions being imposed by lenders. Likewise, retirement asset loans will be relatively less attractive in 2009 given the decline in retirement account values over the past year. However, SBA financing and other special lending programs should remain available and may be a franchisee's best available option outside of friends and family networks.

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