Mistakes Happen

To head them off, training program for sales team is a must

Franchise salespeople can mess up in the process, and the costs are high when they do. An annual compliance training program is a must. Our guest columnist tells how to avoid 10 common mistakes.

By Charles Modell

The sale or award of franchises is the lifeblood of every franchise system. Unfortunately, well-meaning franchisors can be tripped up by the many and varied laws that regulate such sales.

The risk is multiplied when development personnel have not been properly trained. And the stakes are high. In certain states, the sale of a franchise without complete compliance with state franchise laws allows a franchisee to rescind the transaction, obtain a refund of all franchise fees paid or recover all their losses from the franchisor, and compete with the franchise system—even when the mistake caused no harm.

Given the extraordinary losses engendered by even an innocent mistake, franchisors should adopt compliance training programs to minimize the risk.

A good franchise compliance training program should not require hours and hours of study by franchise development personnel. Rather, every franchisor should offer its development people an annual training session, one-half day at a maximum, on the rules that govern the sale of franchises, and "best practices" to avoid mistakes in the sale of franchises.

In larger companies, in-house counsel typically presents these programs, while smaller companies use outside counsel to present (though even larger companies often find their personnel will pay more attention to a program presented by the "out-of-town expert").

However, attendees should not be limited to development personnel. Franchise executives who make decisions concerning sales and operations, and who are responsible for much of the information that must be disclosed to prospective franchisees, should also attend these programs at least once every few years.

A franchise compliance program typically starts with a discussion of the federal and state disclosure laws, the documents to be delivered to prospective franchisees, and the waiting periods for signing agreements. It should also cover differences in the laws on updating franchise documents and re-disclosure to prospective franchisees.

Most franchise systems struggle with what financial information can be presented to prospective franchisees. Your compliance program should include a discussion of financial performance representations, what they are, and when they can be given to prospects. It should also address how to respond to particular financial questions that arise in the sale of franchises in your company.

There are also non-regulatory issues that should be addressed in a compliance program. Issues such as negotiating individual franchise agreements, the nature and scope of amendments that can be negotiated, and the promises and representations made by development people should be addressed.

10 mistakes

A good compliance program should address issues in your system in a way participants will understand, and be able to put to use in everyday practice. The following list of common mistakes made by franchisors is a good starting point for a franchisor looking to train its personnel on avoiding costly mistakes in the sale of franchises.

1. Not fully training—and retraining—franchise salespeople. After all, that is the subject of this article.

2. Answering questions from prospects by guessing. To the extent a franchisee relies on your employee's "guess," your liability may be dependent on whether the employee was sharper than the carnival worker who guesses your weight or age. And if your employee guesses wrong, your loss is far more than a stuffed animal.

3. Making promises that somebody is relying upon without approval from management. Development people are often pressed for assurances, but the company is then left holding the bag when the franchisee looks for somebody to make good on the promises.

4. Making a prohibited financial performance representation. Franchisees may push for financial information, but if this information is given outside the franchise disclosure document, it is likely unlawful.

5. Saying things on the "QT," and thinking they will not get out. Franchisees talk to each other, and there are very few secrets. When something "slips out," damage control can be expensive.

6. Accepting a prospect you know will fail or be a problem. When you know someone is not a proper candidate, and you accept them, you will often be proven right, and the cost of dealing with the problem will be far more than the fees the franchisee pays you.

7. Representing that a particular location is certain to succeed. The key to the success of many businesses may be "location, location, location," but just as the most feared home-run hitters in baseball strike out more often than they hit home runs, some locations that look good on paper will not perform as expected. You do not want to be the subject of a lawsuit based on the guarantee of a home-run location.

8. Making representations that future development by your company or its affiliates will not impact the franchisee's profitability. Nobody can predict the future. Thirty years ago, there was no Internet, and few companies were using alternative sources of distribution. Promising where you might approve other locations, or how you will develop the business in the future, is almost certain to lead to later disappointments.

9. Failing to have franchisees acknowledge that no improper representations were made. Most franchisors use questionnaires that franchisees must complete, immediately prior to being awarded a franchise, confirming that no representations were made to them as to their likelihood of success, or that were contrary to this disclosure document, and that they received all appropriate documents on a timely basis. If you are not using one, talk to your lawyer about designing a form for your company. These questionnaires will not protect a dishonest franchisor, but they may protect against a dishonest franchisee.

10. Not getting complete and proper documentation. All too often, we see signature blanks that do not conform to the names on the face of the contract, incomplete documents, agreements with blank spaces, and even missing pages to agreements. Development people should be trained on obtaining complete and proper documentation, all of which should be reviewed by in-house counsel or another appointed executive.

Paying for itself

A good franchise compliance program will not only help you avoid future problems, but it should also help you sell franchises (thus more than paying for itself). FT

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