Fair Franchising Is Not An Oxymoron: Part 4

By Stanley Turkel, MHS, ISHC

In 1998, the Asian American Hotel Owners Association identified a set of standards called the 12 Points of Fair Franchising by which to judge the actions of franchise companies. Now, nine years later, AAHOA has updated the 12 points and has embarked on a survey of franchisors to assess their compliance with these fair franchising standards. In this Hotel Interactive article, I highlight Point 5.

Point 5: Vendor Exclusivity

In general, franchisees should be free to buy conforming goods from any vendor, not just those mandated by the franchisor. To the extent a franchisor believes it is necessary to mandate vendors for the purpose of establishing standards and specifications for the hotel brands, the franchisor should strive to ensure that the franchisees are receiving competitive prices by providing a list of three or more approved vendors from which franchisees can purchase conforming goods, or by allowing the franchisees to take advantage of the volume discounts arising from the franchisees' group purchases of goods and services.

In addition, because the franchisors receive a significant amount of revenues and commissions from the mandated vendors in return for requiring all franchisees to purchase certain goods and services only from such vendors, franchisors should return these revenues and commissions to the franchisees for the good of the franchise system.

Commentary: In the interest of fair franchising, franchisors should strive to ensure that the franchisees are receiving competitive prices on all goods and services that they are required to purchase from mandated vendors. This can be accomplished in a variety of ways. For example, franchisors should identify three or more approved vendors from whom franchisees can purchase the goods or services. Franchisors also can pass on the volume discounts on prices arising from the purchasing power of the franchisees.

Franchisors should not be allowed to pocket the entire amount of revenues and commissions they receive from mandated vendors in return for requiring all franchisees to purchase certain goods and services from such vendors. Franchisors should retain only that amount of revenues and commissions as necessary for the franchisors to cover the administrative costs of managing the mandated vendor program. All other revenues, commissions and related benefits received from mandated vendors should be invested in programs that benefit the franchisees, including allocating the money to marketing and advertising campaigns for the hotel brands or reducing the franchisees' royalty fees.

Turkel Comment:

It has long been a poorly-kept secret that a major profit center for many franchisors is the sole sourcing requirement that forces franchisees to purchase products only from franchisor-designated vendors. Forbes.com published in October 2006 its "Ten Good Reasons Not to Buy a Franchise." No. 7 is "inflated pricing on supplies" because "almost all franchisors receive kickbacks from the vendors." The practice of franchisors selling products or services at a profit or receiving a commission or rebate from suppliers has also been the cause of many lawsuits. For example, some Blimpie franchisees filed a class action arbitration proceeding against Blimpie's for allegedly taking "kickbacks" that produced inflated prices for products. A group of franchisees of D'Angelo's Sandwich Shops filed suit in Massachusetts claiming that "kickbacks" paid to their franchisor on franchisee purchases violated the Robinson-Patman Act.

A few years ago, Dairy Queen found out in the Collins v. American Dairy Queen litigation that allowing franchisees the right to alternative suppliers can sometimes backfire. In a class action, the franchisees claimed that the franchisor so delayed and obstructed the product approval process that it had effectively forced the franchisees to buy from it.

In May 2003, a federal judge in Minneapolis agreed with some Domino's franchisees that Domino's breached the franchise agreement by requiring franchisees to purchase a new computer system (called PULSE) only from the company. The judge ordered the company to give storeowners the system's specific-actions so they could shop for a better deal in the marketplace. Michael Dady, Esq. of Dady & Garner, attorney for the franchisees said, "franchisors that make themselves the sole supplier of equipment in their franchise agreement can run afoul of anti-trust laws."

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If you would like to reserve an autographed copy of Mr. Turkel's new book, "Great American Hoteliers: Pioneers of Hotel Industry" (to be published at the end of 2007), send an email to stanturkel@aol.com.