



Comments on the “Provisions of Franchise Agreements and Franchisor Business Practices”

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Introduction & Summary^[1]

The Federal Trade Commission (FTC) recently released a Request for Information (RFI) on provisions of franchise agreements and franchisor business practices, including how franchisors may exert control over franchisees and their workers.^[2] The RFI is unaccompanied by a proposed rule at present, but the franchise business model is of interest as concern over the unfair practices in the franchise industry continue to grow. As the FTC’s mission is to protect the public from deceptive and unfair business practices, gathering perspectives on the current state of the franchise model is a timely and important venture to inform future policy and enforcement efforts.^[3]

The success of the franchise business model lies in the unique and mutually beneficial relationship between franchisees and franchisors. Franchisees are more likely to remain in business after two years than independent businesses due to franchisor-provided support such as brand recognition, general business format, and various other assistances. The franchisor benefits from rapid growth and increased brand recognition due to the franchisee-supplied capital that is necessary for business expansion.^[4] Therefore, any future proposed policies regarding franchising should refrain from breaking down the relationship between franchisors and franchisees by drastically limiting franchisor involvement.

At the same time, employment and wage decisions should be reserved for the franchisees to make. At present, franchisors typically have little authority to set wage and employment conditions for the franchised entities. Any future policies that would bestow more authority onto the franchisor would be unwise as it would likely increase employment costs and lead to reclassification of franchisors as joint employers under the National Labor Relation Board’s recently proposed joint-employer standard.^[5] Reclassification of this kind would disincentivize the business model that has proven to support workers, businesses, and entrepreneurs.

These comments specifically address the issue of “franchisors’ control over the wages and working conditions in franchised entities, other than through the terms of franchise agreements,” as requested in the RFI.^[6] For future policy decisions, these comments highlight the importance of the franchise business model, the necessary separation between franchisors and the employment conditions of individual franchises, and the potential impact of the recently proposed joint-employer standard on the franchise model if franchisors possess authority over wage and employment conditions of franchised entities.

The Success of the Franchise Model Is Reliant on the Unique Franchisor/Franchisee Relationship

The RFI opens with a summary of the typical franchisor/franchisee relationship and references the exchange of fees for a business format, use of the franchisor’s trademark, and general brand assistance. This exchange is mutually beneficial for the two parties, resulting in the proven success and attractiveness of the franchise

business model.[7]

Franchisees benefit from assuming the basic operational model and attracting business through pre-possessed brand recognition. With these tools, franchisees can become operational more efficiently and are more likely to remain in business than independent business owners. 92 percent of franchisees remain operational after two years of opening compared to 20 percent of independent businesses.[8] Franchisors benefit from increased brand recognition and rapid business growth without the responsibility of providing capital for each unit. Such benefits should be recognized in any future policy proposals seeking to adjust the level of franchisor involvement.

Franchisors Should Not Possess the Authority Over the Wage and Employment Conditions of Franchised Entities

The RFI asks about how franchisors exercise control over the wages and working conditions of franchised entities.[9] Simply, franchisors should not possess the authority to set wage and employment conditions on behalf of, or in addition to, the franchisee. Such authority would significantly change the relationship between franchisors and franchisees to resemble the more traditional employment model.

Franchisees and their workers are not employees of the franchisor.

Under the current business model, franchisees and their workers are not employees of the franchisor. Upon signing a franchise agreement, the franchisee becomes a business owner and the franchisor is not responsible for ensuring or providing a wage to the franchisee. Instead, the franchisee takes their salary directly from the profits of their franchised unit. Any future policies that would alter this relationship and give the franchisor authority over the wages of franchisees would likely result in the accompanying responsibility of paying each franchisee a fair wage.

Proposed change to the joint employer standard would more easily classify franchisors as joint employers.

Due to their current level of oversight, franchisors are already at risk of reclassification as joint employers under the NLRB's recently proposed changes to the joint-employer standard.[10] Under the proposed rule, an entity would be labelled as a joint employer if it "possesses the authority to control or exercises the power to control particular employees' essential terms and conditions of employment." [11] This is a change from the previous standard which specified that the entity must also exercise that power over the workers to fulfill joint employer status. Any future FTC policy proposals that bestow additional authority over the wage and employment conditions of franchises to the franchisor would likely result in immediate reclassification, thereby holding franchisors responsible for the management and supervision of staff.

Giving Franchisors Wage and Employment Authority Would Disincentivize the Franchise Business Model

Reclassification of franchisors would create dramatic disincentives to participate in the franchise business model.

Franchisors could face significant increases in employment costs if they are deemed responsible for wage and salary payments at individual franchised units. There are approximately 790,500 franchisees in the United States. [12] Assuming that franchisors would be required to pay all franchisees the federal minimum wage, the increase in employment costs for franchisors across the country would be approximately \$5.7 million per hour. This is a conservative estimate of the true cost as it does not account for the workers at each franchise whose wages the

franchisor would likely become partially responsible for. The extra costs would disincentivize franchisors from participating in the franchise model.

In addition to higher employment costs, reclassified franchisors would more readily be implicated in collective bargaining negotiations and held responsible for resolving unfair labor practice claims. Addressing the claims and negotiations would be costly and time consuming, especially for franchisors with thousands of units. As unionization is gaining increased media coverage, this would likely create a significant disincentive to participate in franchising.

Discouraging franchises would be economically disruptive. The franchise model currently contributes more than \$825 billion of economic output, 3 percent of total U.S. gross domestic product.^[13] Disincentivizing the franchise model for franchisors would likely limit entrepreneurship and profitability for new business owners. The labor market would also be disrupted, as franchises are currently responsible for approximately 8.4 million jobs, with an additional 254,000 jobs projected by the end of 2023.^[14] If brands choose to abandon the franchise model, many of these workers could lose their jobs or find it necessary to seek alternative employment.

Conclusion

Franchising is a proven business model that promotes entrepreneurship, increases brand recognition, and makes business growth more efficient. This is contingent on the unique relationship between franchisors and franchisees. Separation of franchisors from wage and employment conditions at individual franchises ensures that the relationship is mutually beneficial and that franchisors are not held responsible for employment costs or implicated in collective bargaining negotiations and unfair labor practice claims. As the FTC considers policy that may alter the franchise relationship, it should ensure that franchisees maintain authority over wage and employment conditions. With a careful examination of franchisors and their role, or lack thereof, in franchise employment conditions, the FTC can ensure that franchisors avoid reclassification as joint employers and that the business model remains intact for the benefit of entrepreneurs, workers, and businesses.

[1] Isabella Hindley is the Labor Market Policy Analyst at the American Action Forum. These comments represent the views of Isabella Hindley and not the views of the American Action Forum, which takes no formal positions as an organization.

[2] “Solicitation for Public Comments on Provisions of Franchise Agreements and Franchisor Business Practices,” U.S. Federal Trade Commission (March 10, 2023) (“RFI”), https://www.ftc.gov/system/files/ftc_gov/pdf/Franchise-RFI.pdf

[3] “About the FTC: Mission,” U.S. Federal Trade Commission (2023), <https://www.ftc.gov/about-ftc>

[4] Cori, Ronald S., et al, “Franchising: a growth option for a company,” Research Gate (May 2017), https://www.researchgate.net/publication/316692162_Franchising_a_growth_option_for_a_company

[5] “Standard for Determining Joint-Employer Status,” National Labor Relations Board (September 7, 2022), <https://www.govinfo.gov/content/pkg/FR-2022-09-07/pdf/2022-19181.pdf>

[6] RFI p. 3

[7] “FranNet Celebrates National Small Business Week: Success Rate Comparison,” FranNet (September 9,

2021), <https://www.allusafranchises.com/blog/what-percentage-franchises-successful/>

[8] “Table 7. Survival of private sector establishments by opening year,” Bureau of Labor Statistics (2022), https://www.bls.gov/bdm/us_age_naics_00_table7.txt

[9] RFI at p. 3.

[10] “Standard for Determining Joint-Employer Status,” National Labor Relations Board (September 7, 2022), <https://www.govinfo.gov/content/pkg/FR-2022-09-07/pdf/2022-19181.pdf>

[11] i.d. p. 1

[12] “2023 Franchising Economic Outlook,” FRANdata (March 28, 2023), <https://www.franchise.org/sites/default/files/2023-03/2023-Franchising-Economic-Report.pdf>

[13] i.d.

[14] i.d.