

## MANAGEMENT &amp; OPERATIONS

# BENEFITS and CHALLENGES

## of Implementing an Area Developer Program

To fairly evaluate whether an area developer program makes sense for a franchisor requires consideration of both the benefits and challenges.

BY CARL KHALIL



**W**hether to implement an area developer program is a decision franchisors make at various times during their business planning. New franchisors may question the need to implement an area developer program from the start. However, established franchisors contemplating growth may wish to expand into an area developer program.

Franchisors in either of these situations must consider the advantages and challenges that an area developer program presents.

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### What is an Area Developer Program?

Most people in the franchise industry are familiar with the concept of a unit franchise, which refers to a single territory where a franchisee locates one or more outlets. In contrast, an area developer program refers to a much larger territory where an area developer concentrates on promoting and supporting the unit franchises within its borders.

Commonly, the area developer pays a higher initial franchise fee than a unit-franchise owner, but in return receives a portion of the fees generated by the franchisees in the territory, including initial franchise fees and royalties. The area developer's duties are to generate unit-franchise leads, assist in the franchise development process and offer certain types of support to the unit franchisees.

### BENEFITS of an Area Developer Program

The primary benefits from an area developer program include an acceleration of income to the franchisor, faster growth and additional support.

- **ACCELERATION OF INCOME**

Perhaps the most appealing aspect of an area developer program is acceleration of income. By selling large territories for substantial initial fees, a franchisor has the ability to generate large amounts of capital. For many franchise systems, such capital can be vital for use in lead generation, hiring and the development of internal support systems. This benefit is especially timely given the existing tighter lending markets.

- **FASTER GROWTH**

Another primary benefit of the area developer program is to increase lead generation and franchise sales. Well-chosen area developers have local contacts and networking abilities that an out-of-state franchisor would not have. Therefore, the franchisor benefits by a local supplement to its internal franchise development efforts.

- **ADDITIONAL SUPPORT**

A problem every business faces is matching internal staffing to external demands without incurring excess payroll costs and overhead. An area developer program creates an additional layer of support, geographically closer to the franchisees, without the additional internal cost or space needs. Franchisors can thereby support growth in outlet count with less run up of internal overhead.

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## CHALLENGES of an Area Developer Program

While the benefits of an area developer program are substantial, there are also challenges that must be managed to ensure that the area developer program is a net positive for the franchisor. These challenges include the trade-off of future revenues, legal risks and quality control issues.

- **FUTURE REVENUE TRADE-OFF**

Although income generated from fees selling area developer territories will boost capital in the near term, there is a trade-off on future revenues. Because the area developer agreement will generally grant the area developer a portion of the initial franchise fees and royalties paid by unit franchisees, the franchisor will suffer from these losses in income revenue. Therefore, a franchisor will want to balance the immediate income against this later cost.

- **LEGAL RISKS**

An area developer program presents unique legal risks. For example, a maneuver by a disgruntled current or former franchisee may include bringing a claim against the franchisor and local area developer. This action could defeat the ability of the franchisor to remove the case to federal court (by defeating diversity jurisdiction) or undermine a forum selection clause in favor of the franchisor's home state. This puts franchisors at risk of having to litigate in a foreign jurisdiction.

Another legal risk is a claim that a franchisor is liable for the misdeeds of an area developer. For example, an area developer may engage in authorized actions purportedly on behalf of the franchisor, exposing the franchisor to the risk of a vicarious liability or other claim. Legal risks can be mitigated, but not eliminated, by drafting an area developer agreement that protects the franchisor against anticipated risks.

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- **QUALITY CONTROL ISSUES**

Just as the quality of work varies from one employee to the next, the development and support given by an area developer will also vary. Franchisees under a weak area developer can be a source of discontent and may result in claims against the franchisor. This risk can be mitigated in at least two ways: first, by the development of a strong area developer training program and manual; and second, by allowing franchisees access to other direct channels and methods of support from the franchisor.

To fairly evaluate whether an area developer program makes sense for a franchisor requires consideration of both the benefits and challenges. Many franchisors, however, accept the challenges presented in return for the benefit of accelerated revenue, faster potential growth and additional support. ■

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