

## Improved Reporting Keeps Franchisee Fees on Track

**LP Innovations tailors its Royalty Assurance program to franchise companies' needs for accurate payments**

BY MICHAEL HARTNETT

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In the world of franchising, where hundreds and hundreds of franchisers license their business concepts and their brands to many thousands of individual franchise owners, a critical component of their business relationship is the accurate calculation and payment of royalty fees that are based on the franchisee's gross sales.

Many of the best-known businesses in America are franchises, and some 320,000 small business owners generate annual retail sales of about \$1 trillion, according to the International Franchise Association. But with such huge numbers and sometimes vast, far-flung franchise networks, how are franchisers to determine the accuracy of the royalty payments being made?

That's where LP Innovations steps in with its new loss prevention program appropriately named Royalty Assurance. Late last year, the Needham, Mass.-based company launched the program to examine cases where royalty payments suggest problems of mismanagement, employee theft or outright under-reporting of sales to reduce royalty payments that typically range from a few percentage points to as high as 12 percent.

When it comes to loss prevention programs in the form of ensuring accurate royalty payments, "The franchise industry is untouched," says Steven May, president of LP Innovations. "With our current, traditional loss prevention clients, we serve 30 retail companies and 6,000 doors, but I believe that within a year we will equal that number within the franchise industry by recovering tens of millions of dollars in royalties."

Mike Mershimer, who recently joined the company as national business director for foodservice and franchising, brings extensive experience from within the franchise industry as well as 20 years in loss prevention. "I have seen franchisers lose 15 to 25 percent of their overall sales to under-reported royalties. We can reduce that figure dramatically. There are millions of dollars out there that franchisers could recover through yield improvement and restitution," Mershimer claims.

Franchise owners are typically small business operators with a wide range of management expertise. In some instances, lower royalty payments can be traced to inefficient operations, employee theft or excessive spoilage. In others, the root of the problem lies with a conscious decision by the business owner to make up for lower earnings by reporting lower sales — and paying lower royalties.

An accurate accounting of royalty payments is important, not just for the franchiser's financial well-being but also for the overall franchisee network because these payments are part of the formula used by the franchiser to plan and finance marketing programs that drive sales for every individual location.

A key resource within the program is LP Innovation's 40 regional offices around the country, which are staffed by loss prevention and operations specialists. The company expects to open another 20 locations this year. This new program has already

attracted the attention of Quiznos Sub, Mrs. Fields Famous Brands, Athlete's Foot and Hallmark.

**CLIENTS' PERSPECTIVE** With some 2,500 Quiznos Sub locations, the Denver, Colo.-based company was among the first franchisers to avail itself of the Royalty Assurance program.

"It's a key part of our business plan," says John Gallivan, CFO and executive vice president. "We are a franchise company and we rely on a voluntary reporting system to calculate royalties due us. The Royalty Assurance program backs that up and ensures that there is integrity and honesty in the reporting system."

Although Quiznos had its own system of internal auditing in place, the company determined that a more extensive program was warranted and, after some research, determined that Royalty Assurance was the only program of its kind. Program results were

positive and almost immediate.

"Since we began the program this year, we have seen an improvement in our yield, and it's coming from improved reporting, not from increased prices or growth," he adds.

Gallivan attributes discrepancies in royalty payments to a variety of issues -- everything from employee theft, sloppy management and inventory control to intentional under-reporting.

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The Mershimer Group, Inc.

the Royalty Assurance program within the first full year of using it. "We have a pretty good system of monitoring that return. We can quantify the benefit of the program and easily measure it against the cost. We are expecting to see the return on investment within the first year," he observes.

As for a longer-term relationship with LP Innovations, Gallivan notes, "It is our intention to maintain it for the near future. They have the resources throughout the country to perform their services and their audits, without incurring the travel costs we would incur if we brought the function back in house."

Mrs. Fields Famous Brands, with some 3,000 points of distribution worldwide, has developed a pilot program with LP Innovations which is scheduled to kick off around the first of the year, says David Brickell, loss prevention director for the Salt Lake City-based company.

"It's exactly the same kind of program I would implement in house. It gives us a network of 40 agents in the field. A similar, in-house program would have cost us \$250,000 more for just a handful of offices, compared to all the locations LP Innovations already has," he says.

Brickell underscores the importance of accurate reporting, pointing out "a part of those royalties go to a marketing fund and if someone is under-reporting sales, this will affect their net royalty and the corporation's marketing. It damages the franchisee network's ability to grow and it means the corporation can't provide the level of services it wants to provide."

In concert with LP Innovations, Mrs. Fields has identified a specific area for the target program and has established benchmarks for sales and the corresponding royalty payments. If the initial program is deemed a success, Brickell says the company's top management will seek approval from its board of directors to go forward with a broader application.

"LP Innovations has been extremely cooperative in helping us take the necessary steps. From all present indications, it looks like LPI and Mrs. Fields will have a relationship going forward with the Royalty Assurance program," he says.

**PROGRAM DETAILS** LP Innovations' Mershimer explains some of the program specifics. "When we have a new client, first we figure out how big the problem is. With a restaurant chain, we will choose a core item and estimate sales based on that one item. We then look at the rest of the product mix -- by market -- and will proj-

ect what the sales should be. For example, with Quiznos Sub, we will use bread and look at what one (location) is getting in sales of bread, then identify those units that are falling below the average. The next step, especially for a company with thousands of units, is to pick a target group and measure their yield for that core item against the average."

A specific amount of bread dough purchased by the franchisee should generate a specific number of sub sales, so one case of bread dough should produce a predictable level of sales volume in subs. "A low yield doesn't mean the franchisee is under-reporting sales, but it's an indicator," says Mershimer.

For other types of franchise operations dealing with food, the core item that helps establish this sales benchmark could be dough for a pizza restaurant, meat or liquor for a sit-down location, May at LP Innovations observes, noting that the formula lends itself to every segment of franchising.

"We could get into dry clean businesses or florists. Anytime you franchise your brand, you need to have a program in place to protect that brand. All that's needed is a core product that can be used to take the temperature of how stores are performing," he adds.

When the lowest-performing stores have been identified, LP Innovations focuses on historical data from the stores and how the franchisees are reporting their sales. "It begs the question: What's going on? The franchisee may be suffering from employee theft or losing track of inventory. We could help them solve a problem and create a more profitable store for that franchisee," says Mershimer.

For those stores requiring a closer look, LP Innovations notifies the owner with a personalized letter informing the franchisee that sales from bread, for example, are lower than the average for the district, and recommends specific steps that can be taken. Does the owner have a loss prevention program in place within stores? Are employees eating lunch and dinner from the restaurant's menu without recording those meals?

That letter has a positive effect, says Mershimer. "You put everyone on notice that we are watching what they do. We also get a lot of franchisee owners calling us about inventory tracking systems and programs to stop employee theft. We have become a resource for franchisees, and not just a cop," he notes.

Once a paper trail has been compiled and evaluated, LP Innovations draws on its network of offices to have specialists conduct on-site investigations of operating units that require closer attention.


"Once we have ruled out employee theft, we launch an investigation. We pose as customers -- mystery shoppers; we monitor the store's activity and how they handle cash and we use surveillance equipment to record transactions. We also do compliance audits to rule out systemic and inventory problems, how they handle inventory and receiving, how they handle waste. We isolate the reasons they are reporting lower sales," May explains.

After laying that groundwork and completing audits, LP Innovations brings in trained investigators who conduct interviews, talking to franchisees and their associates. If the owner is found to have under-reported sales, the case is brought to a conclusion by working out what legal liability, if any, must be addressed in the form of a settlement leading to the appropriate restitution.

**SERVING FRANCHISEES** In addition to the benefits that franchisees can accrue in the form of more efficient operations, LP Innovations has also launched a similar program through which individual owners can address loss prevention issues in their restaurants or stores.

"This program for franchisees is separate from the Royalty Assurance program, but it falls very much in line with our full-service loss prevention programs. We offer them store audits, awareness programs, safety instruction and a 24-hour, seven-days-a-week hotline service -- all for a flat fee," he says.

The market to be served is huge. It consists of smaller franchise owners with one to 10 stores who can't afford their own loss prevention program to large franchise owners at the other end of the spectrum who operate 50 to 200 locations and can benefit from LP Innovation's network of locations in nearby markets.

"If the franchisee controls losses, it is to their benefit and it adds value to the franchiser/franchisee relationship. We have already been invited to various franchise shows to present the loss prevention program to franchisees," Mershimer explains. 

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