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US Franchisees Getting Some Relief From 'Parent' Cos

DOW JONES

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NEW YORK -(Dow Jones)- Some restaurant companies are helping their franchisees save cash by deferring royalty payments or absorbing higher ingredient costs, hoping that taking a financial hit now could help companies emerge stronger from the downturn.

Such moves are being made to help keep store operators afloat in one of the most difficult operating environments in memory, though these companies risk alienating shareholders as earnings suffer in the near term.

In one of the largest splashes yet in providing aid to franchisees, Papa John's International Inc. (PZZA) earlier this week disclosed a number of measures, including reducing the price that franchisees pay for cheese, cutting the fee for online ordering, and selectively deferring or waiving royalty payments, which are the percentage of sales that franchisees pay to the parent company.

Further, Papa John's has waded into financing deals, having already provided partial financing to help sell 26 company-owned stores and providing 100% financing for another deal to sell 37 stores.

Analysts viewed the moves as positive for the long-term health of the company, but Papa John's, after also reporting an earnings miss and possible further earnings declines on additional support to franchisees, saw its shares plunge 16.2% Wednesday. Shares were off another 3.9% in recent trading, at $18.41.

Other franchisors are reluctant to take such steps to help prop up franchisees due to the impact it would have on the bottom line, said Brad Ludington, restaurant analyst at KeyBanc Capital Markets.

"It's really positive that Papa John's is proactively trying to support their franchisees when some competitors may not want to do that because of the earnings impact," Ludington said. "In this market, when so many people are down, there's not a lot of people that want to gamble on the long-term benefit."

Nevertheless, franchisees are asking for relief wherever they can in an economic climate that includes fewer people eating out and higher costs for ingredients. Ken Costello, a franchise attorney at Bryan Cave LLP, said franchisees are approaching his clients to get breaks, but that franchisors are more open to helping stronger operators than weaker ones.

"It's got to be a win-win," said Costello. "A franchisor is not a charitable institution."

As some competitors shut locations, having a healthy franchisee base can help chains pick up market share, a prospect that Papa John's sees in the pizza category, which currently numbers more than 71,000 locations nationwide, according to Technomic Inc. Papa John's Chief Executive Nigel Travis estimated that number could come down by as much as 5% as the industry faces pressure from higher cheese, wheat and other costs, as well as competition from frozen pizzas.

Other chains are using their free cash to provide help to franchisees in similar ways. Last month, Papa John's rival Domino's Pizza Inc. (DPZ) said it would also consider providing cash to help its strongest operators buy underperforming stores, though only as a final resort. Otherwise, the parent company is offering its own financing team to help franchisee find financing options and is being flexible in deferring royalty payments or upgrades to stores.

Cold Stone Creamery, a premium ice-cream chain with roughly 1,350 locations, this year scrapped plans for its annual franchisee convention in Las Vegas, so that its operators don't have to spend money on airfare, hotels and meals for the multi-day event. Instead, a handful of executives are making a 16-stop bus tour to hold meetings with its franchisees.

"It's a significant monetary and time allocation for us," Cold Stone President Dan Beem said, but the chain decided that meeting with smaller groups was more effective.

Cold Stone is also taking rebate money it receives from vendors based on the volume of product purchased and plowing it into keeping costs for its ice-cream mix down. In prior years, the money had been used for programs such as marketing and training.

Others are tweaking their recipes to keep their food costs down. Burger King Holdings Inc. (BKC) is trying out smaller patties for its Whopper Jr. sandwich in some markets, while McDonald's Corp. (MCD) is testing changes to its popular Dollar Menu, including a sandwich called a McDouble with one slice of cheese and two hamburger patties to replace its Double Cheeseburger.

On the smaller end, Rising Roll Gourmet, a gourmet sandwich shop with 12 locations all operated by franchisees, cut down on the size of its sandwich rolls, introducing a 3.2-ounce roll instead of a 5.5-ounce one that helped chop 19% off of costs.

Said Mike Lassiter, president of Rising Roll Franchising Co., the franchisor of the Rising Roll chain: "When [other restaurants] are seeing their costs go up and we're seeing our key cost go down, it's huge."

-By Paul Ziobro, Dow Jones Newswires; 201-938-2046; paul.ziobro@dowjones.com