

Why Purchasing Co-ops Makes Sense

By Stanley Turkel

Since many of my clients are hotel owners, I know first hand that the current status of hotel franchising is not very conducive to a mutually successful relationship. A growing number of franchisees are becoming unhappy with the traditional one-sided license agreements.

Four main issues cause franchisees the most difficulty: (1) restricted sourcing of products; (2) encroachment; (3) liquidated damages upon termination; and (4) franchisor reluctance to recognize independent franchise advisory councils. This article will focus on the restricted sourcing some franchising licensing agreements stipulate.

One important perceived benefit of joining a franchise system is the belief that goods and services can be purchased less expensively because of the collective power of the system. It is logical to assume that multiple hotel franchisees should be able to secure very significant discounts if they merge their purchasing volumes.

Over time, franchise companies realized that this area provided extraordinary opportunities for them to create a profitable income source.

By restricting sourcing of services and products to "approved and preferred vendors," franchisors have been able to create very profitable purchasing subsidiaries which achieve results in several major ways.

- They negotiate rebates, discounts and commissions with suppliers, manufacturers and vendors which they retain most for themselves.
- They cause those same vendors to supply company-owned hotels at a less cost for the same goods and services.
- They insist that the vendors and providers of services perform all or some of the franchise training for free, thus reducing or eliminating the franchisor's obligation to perform ongoing training and support. The vendors naturally pass on the cost to the franchisees.
- They invest in and sometimes acquire the sources of supply while withholding approval of competitors.

How can franchisees purchase their products, goods and services as inexpensively as possible? The best alternative is the creation of an independent national purchasing cooperative. A co-op is a business corporation whose goal is

to make a profit. But by federal law, co-op profits must be distributed to its members through a mandatory annual patronage dividend. The co-op works by pooling the purchasing power of its members to negotiate the lowest possible cost of products and service used in common by most of its members. At the end of each fiscal year, the co-op declares a patronage dividend wherein most of the co-op's "earnings" are distributed in proportion to each member's patronage.

The American Association of Franchisees and Dealers (AAFD) is in the process of creating a hospitality purchasing cooperative for the benefit of member hotel franchisees. It is worth looking into. (American Association of Franchisees & Dealers, P.O. Box 81887, San Diego, CA 92138-1887. Phone is 800/733-9858. Fax is 619/209-3777. Contact is Gary Erichsen.)

By Stanley Turkel, MHS, ISHC, a New York-based hotel consultant specializing in due diligence studies, operational audits, asset management and litigation support services. He can be reached at 212/838-5467. In future issues, Turkel will comment on encroachment, liquidated damages at termination and franchisee advisory councils.