THE FRANCHISE COOPERATIVE HANDBOOK

(Summary Version)

Published by the

International Franchise Association

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International Franchise Association
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www.franchise.org
# Franchise Co-op Handbook
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INTRODUCTION TO COOPERATIVES

SUMMARY

The cooperative is a long-standing and highly successful business concept that has created a unique type of organization designed to serve only the benefit of its members. From humble beginnings, the cooperative concept has evolved into a major method for individuals and small businesses to join together to promote their mutual interests and benefits. Cooperatives have succeeded in numerous functions, especially purchasing, marketing, advertising, and services, as they have helped their members realize economies of scale, increase revenues, decrease costs, and increase profits in ways not available through normal business methods. In unique roles that go beyond those of stockholder and customer, co-op members, directors, and officers assume unique, serious responsibilities, yet receive unique benefits. As a similarly unique business concept that relies on mutual support and benefit for its success, franchising shares and benefits from the strengths of the cooperative concept.

ADVANTAGES AND DISADVANTAGES OF COOPERATIVES
by J. Gary McDavid, Esq., McDermott, Will & Emery, Washington, DC

Cooperatives have long been used in many different franchises and industries for many different reasons. In evaluating whether a cooperative may be helpful to you and your organization, the following are acknowledged as a cooperative’s principal advantages and disadvantages.

10 ADVANTAGES
1. Greater Size and Strength In The Marketplace.
2. Sharing Ideas.
3. Non-Profit Organization.
4. Member Owned and Controlled.
5. Flexible Structure.
7. Unique Capital Raising Mechanism.
8. Tax Deduction.
9. Services Available To Co-ops.

DISADVANTAGES
Cooperatives have only a handful of disadvantages:
A. Legal and Administrative Costs.
B. Tax Issues.
C. Lack of Returns on Invested Capital.
Chapter 1 Sidebar/Dunkin’ Donuts

DUNKIN’ DONUTS: Development of an Early Franchise Cooperative
by: Bob Rosenberg, President, Allied Domecq Retailing, USA, Randolph, MA.

Since its founding in 1950, Dunkin’ Donuts has been one of the premier franchise success stories with more than 3,718 stores (as of fiscal year end 8/97) in 43 states. Nationwide they sell a total of 4.7 million donuts per day, or over 1.5 billion per year and 2 million cups of coffee per day or approximately 650 million cups per year, making it one of the largest chains of its kind in the world. It was the first to develop a regional cooperative program in the fast food industry, and its successful example has served as the model for more than two decades.

SUMMARY

In the early 1970s, Dunkin’ Donuts faced a serious problem that called into question the profitability of many of its franchisees—the price explosion of key basic commodities, such as wheat, oil and sugar. Thanks to forward-looking executive efforts, the company launched a multiple-stage process that culminated in the formation of a national purchasing and five regional cooperative efforts. The purchasing cooperative concept has helped Dunkin’ Donuts franchisees not only survive the turbulent 1970s, but improve their profit margins, reduce their risks, and solve critical shortcomings in distribution and manufacturing throughout the past 21 years.

Chapter 2

HOW SUCCESSFUL COOPERATIVES EVOLVE
by Ken Keymer, President, Sonic Industries, Inc., Oklahoma City, Oklahoma

Sonic Industries has more than 350 franchisees who operate 1,450 restaurants and 260 company stores. Working together, the franchisees and company stores use a formal advertising cooperative in each major market and a national product and purchasing committee to build brand awareness and pool purchasing power. The advertising co-op members agree on a marketing program while the national purchasing committee standardizes the menu, selects products through an approved supplier, and reviews strategies. The vice president of purchasing coordinates the purchasing committee and negotiates price and terms with the distributors on the group’s behalf. Regional vice presidents and marketing managers coordinate the market co-ops, supported by Sonic Industries’ marketing team.

While this article refers to principles for operating an advertising cooperative, the principles of trust, mutual support, education, and shared responsibility are basic to all types of cooperatives.

SUMMARY

Cooperatives are not static organizations, frozen in time. In fact, the nature and role of co-ops grow, change, and evolve as do the companies and members they serve. They change through predictable stages. Over time, as franchisors recognize the need to sanction these organizations, co-ops evolve from dealing with more local concerns to broadening their geographic span. Then, as the number of units in a franchise grow, the co-ops narrow their focus again. As the spans change, widening and narrowing, so do the co-ops’ concerns, focus, and demands on their elected officers. Most important, these changes dictate different approaches and attitudes by franchisors and franchisees alike.
Chapter 3

HOW TO SUCCEED WITH AN INFORMAL COOPERATIVE
by Jack Hellriegel, Chief Operations Officer, A&W Restaurants, Livonia, MI

SUMMARY

One of the primary reasons that a franchise system exists is to continue to grow its franchisees’ profits. An informal cooperative program can contribute significantly to that objective. Although the franchisor’s field representatives must invest time and effort to help an informal cooperative succeed, the benefits to the system, the franchisees, and the representative can be enormous. Franchisees must be actively involved in setting up and administering the cooperative program from the beginning. Successful informal cooperatives can enhance the working relationship between franchisor and franchisee and lead to additional opportunities for cooperative ventures that reduce costs and improve profits. Field representatives can follow a simple 10-step process to establish a working informal cooperative.

Chapter 4

ADVERTISING COOPERATIVES
By Robert L. Perry, Handbook Editor, College Park, MD

SUMMARY

Numerous major brand name franchisors have proven that advertising cooperatives can help them dominate local markets. Advertising co-ops have become another significant tool that franchisors and franchisees can use to penetrate their markets and increase their sales more rapidly than otherwise possible. They should be formed when franchisees in the same market or region can maximize the effectiveness of their media dollars by joining together. However, for important legal and regulatory reasons, ad co-ops differ significantly from purchasing co-ops.
STRUCTURE: The Key To An Effective Co-Op System
by Jay Butgereit, Senior Field Marketing Manager, BLIMPIE International, Inc., Atlanta, GA

SUMMARY

The key to unlocking the vast potential of an advertising cooperative system is to institute a coo-op infrastructure. A structure creates the following advantages:
1. Identified, responsible lines of communication,
2. Credible leadership from the ranks of franchisees,
3. Commitment to common goals, and
4. Focused forums to take advantage of group buying power.
For example, at Blimpie, during 1997 alone, three-quarters of our franchisees saved more than $91,000 with just one co-op agreement for national print advertising.

Sidebar: KFC NATIONAL PURCHASING COOPERATIVE, INC.

From One To Many: The Evolution of A Successful Cooperative
By Reesey Price, Communications Specialist, KFC National Purchasing Cooperative, Inc.
d/b/a FoodService Purchasing Cooperative, Inc., Louisville, Kentucky

SUMMARY

FoodService Purchasing Cooperative, Inc. is somewhat different from the usual purchasing co-op because it operates separately from any franchise corporation. Although primarily serving its members from Kentucky Fried Chicken (KFC (R)) and Taco Bell (R) franchisees, it sells products, equipment, and packaging to a variety of non-competing concepts, including Long John Silver’s (R), Dairy Queen (R), Fazoli’s (R), and others.

Chapter 5

BASIC LEGAL DOCUMENTS FOR FRANCHISE COOPERATIVES
by Donald A. Frederick, Program Leader, Laws, Policy, Governance
U.S. Department of Agriculture, Cooperative Services, Washington, DC

SUMMARY

Cooperatives must fulfill basic legal requirements when they are established. They must prepare and file articles of incorporation and adopt a set of bylaws, a basic membership agreement, and governing policies. These documents act as a firm foundation for the cooperative’s organization and operations. A Director Handbook facilitates the board of directors’ effective and efficient conduct of business.

INTRODUCTION

Construction of a solid foundation under a building requires the proper use of numerous materials and tools. Only when the foundation is securely in place can you build the remainder of the structure with confidence that it will become a permanent part of the community.
Likewise, to make sure it is prepared to serve its members for years to come, a cooperative requires a solid foundation. That foundation consists of laws and legal documents that define the organization and operation of the association. This chapter summarizes the legal underpinnings that support the cooperative venture and suggests a management tool—the director handbook—that facilitates the effective use of these and other important documents.

Case Study: RESTAURANT SERVICES INC. (BURGER KING)

BEYOND COST SAVINGS: System Unity Spurred By Burger King Cooperative
by George Hoffman, President & CEO, Restaurant Services, Inc., Coral Gables, FL

Patronage dividends and cost savings are obvious benefits that Restaurant Services, Inc. (RSI) has made to the Burger King system since it began in 1991. However, we are convinced that RSI’s “behind the scenes” contributions are perhaps more important.

For example, the system’s 99-cent WHOPPER (r) promotion has produced excellent results, yet despite a brief setback during 1997, no one has worried about having enough beef. It was there when we needed it because the cooperative had a foundation in place to protect its members.

Similarly, during Spring 1995, RSI came through when the country’s prime lettuce supply area suffered severe flooding. Suddenly, there were severe lettuce shortages across the country, but thanks to RSI’s supply line, our members did not have to worry about having enough lettuce.

Many franchise systems remain constantly concerned about their supply systems, but thanks to our experience and infrastructure, most of our members take our supply system for granted. They can do so because RSI and Burger King together work to make sure that whether franchisees own one restaurant or 50, they can be assured that their day-to-day supplies will be there when they need them—with the low cost and high quality the system needs to compete in perhaps the most competitive arena in franchising—fast food.

Chapter 6

HOW COOPERATIVES OPERATE
by Stanley Dreyer, Vice President, National Cooperative Bank, Washington, DC

SUMMARY

A successful purchasing cooperative meets an identified economic need of its members and helps them achieve their profitability goals by reducing costs and increasing the quality of the goods and services they purchase. It is supported by a membership that patronizes the co-op’s services and that is committed to its long-term success. An enthusiastic board of directors hires qualified management and supports its efforts to run the daily operations efficiently and effectively on behalf of the members. The directors, the members, and the managers establish and maintain a positive relationship so that the needs of the one are fulfilled by the cooperation of the many.
Chapter 7

HOW TO FINANCE A CO-OP
by Judith E. Sandberg, Managing Director, National Cooperative Bank, Washington, DC

SUMMARY

Every co-op must establish a solid foundation from which to grow and offer services to the membership. This foundation is established with the initial base of equity capital raised from its members. These equity contributions -- risk capital -- establish an important link between the co-op and its membership. Members may contribute their equity in several ways: direct investment, retained earnings/margins, and deposits or volume investment. In addition to receiving the services provided by the co-op, its members may receive “patronage refunds” as a “return” on their equity investment. Co-ops may also need to raise debt capital to finance daily operations and long-term growth. Debt can be raised from both traditional and non-traditional sources, including banks, insurance companies, leasing firms, and other specialized lending institutions.

When a purchasing co-op is formed, it is as important to consider the capitalization structure as it is to consider the member services to be provided. Member capital typically represents the least expensive form of capital, and most important, it gauges the members’ commitment to the venture. Member’s ownership capital funds the co-op’s daily operations, provides adequate facilities, and creates a base to obtain external financing.

Chapter 8

10 STEPS TO SUCCESS WITH A FRANCHISE COOPERATIVE
by Paul Hazen, Chief Operating Officer,
National Cooperative Business Association, Washington, DC

SUMMARY

All successful franchise cooperatives, whether purchasing, advertising, or service, share 10 steps that franchises should follow if they wish to maximize the benefits that cooperatives offer.

Follow these 10 steps to increase your chances of succeeding with a cooperative:

STEP 1: Identify Need and Establish A Clear Mission, Purpose, and Goal.
STEP 2: Gain Broad and Deep Member Commitment.
STEP 3: Establish Structure.
STEP 4: Take Advantage Of Available Expertise.
STEP 5: Prepare A Detailed Business Plan.
STEP 7: Have Adequate Financing In Hand.
STEP 8: Maintain Consistent Quality Assurance Standards.
STEP 9: Set Clear Roles and Duties for Co-op Boards and Executives.
STEP 10: Promote Continuous Learning Among Franchisees, Directors, Executives, Employees, and Vendors.
Case Study: JLAF PURCHASING COOPERATIVE

JLAF Purchasing Cooperative Greases Path To Profitability
by Miles Goodman, V. P. and General Manager, JLAF Purchasing Co-op, Baltimore, Maryland

SUMMARY

The Jiffy Lube Association of Franchisees (JLAF) launched a successful Cooperative in 1991 to increase its members’ profits. Since its founding, through relationships with 47 vendors covering more than 50 products, the co-op has reduced purchase prices and paid cash rebates totaling millions of dollars. The co-op, governed by an eight-member Board of Directors, acts as a broker and monitor for the vendors who drop-ship products or provide services directly to the local franchisees. Co-op membership has increased from 450 stores in 1992 to 720 in 1997.

Case Study: POPCA

POPCA’s Success Leads To Steady Expansion
by Richard Porter, Director of Purchasing, POPCA, Atlanta, GA

SUMMARY

POPCA, the Popeyes Operators Cooperative Purchasing Association, saves its 900-member restaurants a total of at least $1 million a year. Yet, member dues total just $400 a year. POPCA is governed by a balanced board of directors with four corporate and four franchisee members. The cooperative, founded in 1993, was so successful in saving money with common items that it rapidly added signage, menu boards, and equipment purchases to its activities. It continues to explore new ways to save its members money and add more convenience to their operations.

Appendix A

KEY DISCLOSURE ISSUES FOR FRanchise Cooperatives
by Carl Zwisler, Esq. Duane, Morris & Heckscher LLP, Washington, DC

SUMMARY

Although the requirements are not by any means complete, franchisors face extensive disclosure obligations about both formal and informal cooperatives in their Uniform Offering Circulars (UFOCs). The extensive requirements come from the amendments to the UFOC Guidelines that took effect during 1994. These new guidelines require substantive disclosures about cooperative fees and payment structures, voting power, control, revenues, products and services, rebates, financing terms, and more. Faced with these requirements, franchisors need to fashion or modify their cooperative agreements with these extensive disclosures in mind. They should consider these four steps:
A) Make all cooperative agreements written and formal.
B) Prescribe the standard terms which the cooperatives may use.
C) Require regular reporting of all cooperative activities.
D) Reduce the frequency of material changes in co-op agreements and permit these changes to become effective only at the time that the company must renew its offering circulars.
Appendix B

TAX ADVANTAGES OF FRANCHISE COOPERATIVES
by J. Gary McDavid, Esq. McDermott, Will & Emery, Washington, DC

SUMMARY

Like other cooperatives, franchise co-ops are entitled to tax advantages under federal and state tax laws that are extremely important to their financial success. These tax benefits generally allow a cooperative to take a deduction for patronage refund payments made to its members, and this deduction commonly eliminates federal and state tax on the cooperative’s earnings on business with or for its members—the co-op’s patronage earnings.

The basic theory behind cooperative taxation is that the cooperative and its members are taxed once on the co-op’s patronage earnings each year. Through the patronage dividend mechanism, co-op members are taxed directly on their share of the co-op’s patronage earnings each year, and the co-op itself is not taxed. This single tax can be contrasted with the double tax (once at the corporate level and again at the shareholder level) imposed on most business corporations.

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