Legal Considerations for Franchisors Expanding into Inner-City Markets

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Franchising as a business model largely originated in the suburbs, with companies selling franchises for units to be opened in strip malls, shopping centers, and retail plazas throughout the United States. As markets became saturated, competition grew, and demographics changed, franchisors started exploring new opportunities for growth, which involved considering or reconsidering those inner-city markets that might initially have been thought to be too expensive, too office-focused, too non-traditional, or just too risky. While many companies have sought expansion overseas,[1] an enormous amount of domestic retail demand remains unmet.[2] Indeed, many franchisors have neglected the significant prospects for growth that exist in the United States. To find them, companies need only look just a bit beyond their suburban strongholds and toward downtown areas of cities across the United States.

The Initiative for a Competitive Inner City (ICIC), a research group founded by faculty from Harvard Business School that strives to promote

1. *See* Michael H. Seid & Kay Marie Ainsley, *Starting Up in an Urban Market*, Entrepreneur (June 26, 2001), https://www.entrepreneur.com/article/41692 (acknowledging that international franchise development has expanded rapidly in recent years).
2. *See generally* Boston Consulting Group, *The Business Case for Pursuing Retail Opportunities in the Inner City*, The Initiative for a Competitive Inner City (June 1998), http://icic.org/wp-content/uploads/2016/04/ICIC_BCG-retail-study.pdf (explaining the potential of inner-city markets).

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economic prosperity in inner cities throughout the United States,[3] defines "inner cities" as urban areas that are economically distressed in relation to surrounding areas.[4] In the context of franchising, that definition might be too simple and could conceal the existence of franchise development opportunities. For example, downtown regions have traditionally been made up of people who worked there, rather than lived, making them unattractive to concepts that count on evening or "going home" traffic. However, many large cities are turning this model on its head as younger workers choose to live where they work.[5] In these markets, the infrastructure for successful franchising already exists, and "there is no need to struggle with a new language, culture, [or] currency,"[6] as is often the case in international markets. Unfortunately, many inner-city regions also experience higher levels of unemployment and poverty compared to surrounding areas,[7] and franchisors will often be forced to make critical and creative choices to adapt their concepts to prevailing real estate constraints (including both size of available space and costs).

Nevertheless, inner-city markets present a tremendous opportunity to franchisors because of their concentrated, aggregate buying power and changing demographics. Conservatively, U.S. inner cities contain an estimated 7.7 million households, who collectively contribute over $85 billion in annual retail spending.[8] The retail market in downtown areas is "concentrated by consumers with significant aggregate spending power, yet lacking

3. *See* Claude Tolbert & Philip Alphonse, *Magic J and Ventures in the Inner-City: MVP in America's New Emerging Market*, Poverty & Prejudice: Breaking the Chains of Inner City Poverty (May 27, 1999), https://web.stanford.edu/class/e297c/poverty_prejudice/citypoverty/hmagic.htm (explaining the mission of the Initiative for a Competitive Inner City); *see also* The Initiative for a Competitive Inner City, *Key Battlegrounds for the War On Poverty* (Jan. 2014), http://icic.org/wp-content/uploads/2014/02/InnerCityInFocus_WarOnPoverty_Infographic.pdf [hereinafter *Key Battlegrounds*] (same).

4. *See* Boston Consulting Group, *supra* note 2, at 29 (defining "inner cities"); *see also Key Battlegrounds*, *supra* note 3 (displaying statistics about inner-city communities).

5. Between 2013 and 2016, Chicago added an average of 5,000 to 7,000 apartment units per year. Analytics Contributor, *Apartment Completion Volumes Spike in Chicago*, RealPage (Feb. 27, 2018), https://www.realpage.com/analytics/apartment-completion-volumes-spike-chicago. However, in 2017 alone, "developers brought 10,545 new apartments to the market," which constitutes an increase of nearly 50% over 2016's completion volume. *Id.* "Since the start of 2010, about 40,000 units have come online across Chicago." *Id.*

6. Boston Consulting Group, *supra* note 2, at 2. *See* Seid & Ainsley, *supra* note 1 (noting that the infrastructure for successful franchising already exists in inner-city markets). Typically, a franchisor's headquarters, field operations, distribution facilities, training centers and programs, and everything else needed to support franchisees are already in place. Seid & Ainsley, *supra* note 1. These resources can be leveraged to assist inner-city franchisees, while avoiding the extensive costs and headaches posed by international expansion. *Id.*

7. *See Key Battlegrounds*, *supra* note 3 (displaying statistics about inner-city communities).

8. *See* Boston Consulting Group, *supra* note 2, at 5 (quantifying the buying power of inner-city communities in the aggregate). These statistics are from 1998, and the buying power of these communities has likely increased as downtown regions have grown steadily over the past several years with the surge of young people. *See generally* The Initiative for a Competitive Inner City, *Growing Healthy Economies: Leveraging America's Urban Food Cluster* (2013), http://icic.org/wp-content/uploads/2016/04/ICIC_RESEARCH_USCM_2013_REV1.pdf [hereinafter *Growing Healthy Economies*] (discussing the expansion of inner-city regions of the United States).

in competitive offerings, and underpenetrated by retailers of all kinds," including franchise companies.[9] This vast appetite for spending has gone largely unmet by franchise systems, with retail demand averaging twenty-five percent in many cities and reaching up to sixty percent in others.[10] Indeed, the concentrated customer base and aggregate spending power are cited as the primary competitive advantages of inner-city markets.[11]

Within the past few decades, inner-city areas have experienced a resurgence as young adults under the age of thirty-five have increasingly moved into downtown regions.[12] "Since 1990, downtowns and central neighborhoods in cities across the country have attracted significantly more educated and higher-income residents."[13] As inner-city markets have become increasingly populated with younger generations, the aggregate spending on some products and services has started to exceed spending in some suburban areas.[14] Historically, downtown areas were composed of workers rather than dwellers, which resulted in high daytime demand but lower-to-non-existent nighttime demand and, in many cases, a more streamlined offering for both franchise and non-franchise concepts. As the demographics of these areas continue to change, franchisors will be forced to reconsider their strategies within inner-city markets. Put simply, these communities are full of residents who have a certain level of disposable income and appetite for retail spending, but are unable to purchase goods and services because franchise companies have not yet expanded into their neighborhoods.[15] Despite the untapped potential of downtown areas, franchises have been slow to emerge.

Along with the potential, inner-city expansion brings with it a number of challenges franchisors should consider. This article discusses several of those challenges and seeks to identify the various considerations franchisors

9. Boston Consulting Group, *supra* note 2, at 5.

10. *See id.* (explaining retail demand in inner-city markets). Specifically, unmet demand for retail spending approaches thirty percent in Boston, Massachusetts; forty percent in Chicago, Illinois; and sixty percent in Harlem, New York, New York. *Id.*

11. *See id.* (identifying competitive advantages of inner-city markets); *see also* Tolbert & Alphonse, *supra* note 3 (same). The Initiative for a Competitive Inner City has identified a number of additional competitive advantages associated with expansion in inner cities, including strategic downtown locations and an underutilized labor supply. *See id.* at 6.

12. *See* Luke Juday, *The Changing Shape of American Cities*, Univ. of Va. Demographics Research Group 3 (Feb. 2015), https://demographics.coopercenter.org/sites/demographics/files/ChangingShape-AmericanCities_UVA-CooperCenter_February2015.pdf (examining the changing demographics in cities across the United States).

13. Juday, *supra* note 12, at 4.

14. *See* Seid & Ainsley, *supra* note 1 (noting that aggregate spending in inner-city markets often exceeds aggregate spending in suburban areas); *see also* Boston Consulting Group, *supra* note 2, at 12 (same). In a study conducted by the Boston Consulting Group and the Initiative for a Competitive Inner City, which analyzed the performance of drugstores in the inner city compared to suburban areas, the researchers found that inner-city drugstores can generate sales up to forty-five percent higher than the regional average, with some areas achieving double the regional average. Boston Consulting Group, *supra* note 2, at 12.

15. *See* Devlin Smith, *Are Inner City Franchise Programs Working?*, Entrepreneur (Nov. 5, 2001), https://www.entrepreneur.com/article/46030 (explaining that many inner-city regions have an increased appetite for franchise concepts).

should keep in mind as they explore inner-city opportunities. First, Section I presents a discussion of general operational issues, ranging from incorporating local considerations to improving operational flexibility. In Section II, the focus is on real estate considerations concerning both territories and unit-level issues. Next, Section III includes an analysis of recruitment and employment issues, including recruitment and vetting of franchisees and the hiring, training, and retention of employees. Finally, Section IV discusses crime and the perception of crime in these areas, along with their impact on franchised units, focusing on an examination of crime-prevention policies and strategies for avoiding liability. By keeping many of these considerations in mind, franchisors will be better equipped to expand into inner-city markets, which offer underdeveloped and unique retail space, an accessible labor market, and the potential for intense local brand loyalty.[16]

I. General Operational Considerations

Franchise expansion into inner-city markets shares many of the same considerations as franchising in traditional markets—managing system standards, recruiting well-qualified franchisees, and generating and collecting revenue, among other things. Yet, inner-city franchising presents its own unique angles on many of the traditional issues facing franchise systems. These issues can be broadly divided into two categories: those that come from an outward look and those that come from an inward look. First, franchisors should consider and examine the cities themselves, including the local, community-based factors impacting franchise expansion. Second, franchisors should look inward at their systems and operations to maximize their effectiveness within inner-city markets. By combining an outward examination of target markets with an internal examination of operational practices, franchisors can set themselves up for successful expansion.

A. *The "Locality Factor" of Inner-City Franchising*

As a preliminary matter, franchisors must identify what brand-critical characteristics distinguish inner-city markets from suburban markets, aside from the locations themselves. Given these differences, many franchisors have historically struggled to enter inner-city areas due to a lack of understanding of the wants and needs of the local markets, compounded by a relatively rapidly changing landscape as inner cities morph into hubs for both daytime and nighttime activities. While a franchise generally relies on the broad name recognition of a large company, the success of individual units also depends upon various local considerations. To that end, franchisors should rid themselves of any assumptions that all inner cities have the same

16. *See generally* Seid & Ainsley, *supra* note 1 (illustrating the benefits of franchising in inner-city markets).

characteristics.[17] A successful business must consider the consumers living in a given region.[18] This "locality factor" requires a franchisor to evaluate various aspects of a local market to determine how best to tailor its business model to that market. The critical considerations can be consolidated into two overarching categories: (1) gaining a general understanding of the community and customers; and (2) developing the operational flexibility to tailor the franchise offering to local needs.

Initially, franchisors should undertake a thorough evaluation of a targeted inner-city market to gain a sense of the community, its customers, their desires, and the ever-important trends in the market. Franchisors should strive to understand local community tastes and preferences to establish relationships with community organizations, which will aid in expansion.[19] In total, 328 areas meet the definition of an "inner city," spread across U.S. cities that each have a population exceeding 75,000 people.[20] These 328 inner cities account for roughly ten percent of the total population of the United States.[21] Undoubtedly, no two cities are the same—each contains its own unique characteristics and communities. Thus, in the early stages of franchise expansion, franchisors should collaborate with local governments and community organizations, and should place an emphasis on exploring expansion opportunities that appeal to potential franchisees and the customers living in their communities.[22] This step should involve a preliminary determination of what barriers may exist—real or perceived—that may keep people from wanting particular products in their community. Clearly, not all franchises are suitable in all markets, at least not on a broad scale or in the same way that the concept might operate in the suburbs. For example, a lawn-care franchisor might, at first blush, think it impossible to mount a successful business in the inner cities of Chicago due to the lack of residents with extensive greenspaces. But, by looking outward to determine the local market's needs, and looking inward to determine how its business model might adapt to meet those needs, the lawn-care franchisor might very well find untapped opportunities by refocusing its business model on small greenspaces or common areas—both indoors and out—that, if mined properly, can provide a strong base on which to support the basics of a business.

17. *See generally* MSA Worldwide, *The Challenges of Entering Inner-City Neighborhoods*, https://www.msaworldwide.com/blog/the_challenges_of_entering_inner-city_neighborhoods ("[Franchisors] have to shake off any preconceived notions about the emerging markets, including an assumption that all of the inner cities share the same attributes.").

18. *See* Jose Torres, *Connecting to Hispanic Consumers Through Hispanic Franchisees*, Franchising World (Feb. 2012), https://www.thefreelibrary.com/Connecting+to+Hispanic+consumers+through+Hispanic+franchisees%3a...-a0280386764 (emphasizing the importance of characteristics unique to local areas).

19. *See generally* MSA Worldwide, *supra* note 17 (noting that franchisors should seek to understand local communities for successful inner-city franchising).

20. *Key Battlegrounds*, *supra* note 3.

21. *Id.*

22. *See* Smith, *supra* note 15 (explaining that franchisors should tailor their franchise offering to specific markets).

Once that determination is made, the franchisor must determine whether there is enough interest from existing or prospective franchisees who may want to bring a specific franchise concept to their communities, and whether the pool of customers is large enough to support the franchise. Without both factors, an inner-city franchise is doomed to fail.

Once a franchisor recognizes that there is an appetite for their franchise system from both prospective franchisees and potential customers, the next step is to consider how to bring that concept to fruition. Many downtown residents may be unaccustomed to franchise investment in their communities and will have a certain level of skepticism as to whether there is a genuine community interest.[23] In response to that hurdle, franchisors should strive to connect with members of the community from the onset of the expansion. This might involve seeking potential franchisees who live in the communities and who are connected to other local residents. Considerations for attracting franchisees in inner-city markets are discussed in more detail in Section III.

B. *Viability of Franchise Concepts in Inner-City Markets*

In addition to understanding local tastes and preferences, franchisors might have to adapt their franchise systems to achieve success in inner-city markets. This requires a certain degree of operational flexibility to tailor the franchise offering to local needs. To that end, the ICIC has noted that successful inner-city retailers have managed to succeed due to an understanding of "inner-city dynamics and the varied preferences of many distinctive micro-markets."[24] Often, these companies have empowered local store managers by giving them the authority to adapt merchandise to local customers' needs on a store-by-store basis.[25] In other words, franchisors may have to modify the products and services they offer to meet customer preference.[26] If a company requires its franchisees to sell its products at a price higher than what a community is used to paying, the franchisee may have trouble establishing long-term success. If a franchisee's product or service is too expensive or too unusual, the local community might be reluctant to support the franchisee and the overall business.[27] In addition, local marketing and advertising may have to be revised to account for language and cultural differences, which

23. *See id*. (noting that many inner-city residents may be skeptical to franchise expansion in their communities).

24. Boston Consulting Group, *supra* note 2, at 18.

25. *See id.* (noting that successful inner-city retailers provide for decision making at the store level).

26. *See* MSA Worldwide, *supra* note 17 (explaining that consumer tastes vary from location to location).

27. *See generally* Nancey Green Leigh et al., *Using Franchises to Revitalize an Urban Corridor*; *Improve Neighborhood Access to Retail and Services*, *and Promote Sustainable Local Economic Development*, Ga. Inst. of Tech. (Dec. 2016), http://serve-learn-sustain.gatech.edu/sites/default/files/documents/Toolkit-Docs/Exterior-Case-Studies/nine-franchises-for-the-hollowell-parkway-corridor.pdf (evaluating the viability of various franchise concepts based on local demand for their products and services).

will impact signage, distributions, and other marketing materials.[28] Although some modification of the franchise may be necessary, franchisors should be careful not to change or lower their system standards, which would be counterproductive to a successful franchisor-franchisee relationship.[29]

Some franchisors, like McDonald's and Burger King, have seen success with their traditional concepts in inner-city markets for decades, while other franchisors are crafting new concepts specifically designed for downtown markets. Taco Bell serves as a prime example of a franchisor overhauling its franchise offering to adapt to the generational shift toward urban areas. According to brand officials, Taco Bell is "underrepresented" in inner-city markets, "which [are] viewed as potential locations for the chain's Taco Bell Cantina variation."[30] Through this relatively new "Cantina" concept, Taco Bell has introduced a more modern restaurant that serves alcohol and offers tapas-style dishes.[31] The company hopes to eventually build around 300 Cantinas, which will each be specifically designed to "reflect the local community and respect the architecture of the existing buildings."[32] Moreover, they will feature digital menu boards, mobile ordering, energy efficiency, and open kitchens, all of which are intended to appeal to inner-city markets and urban communities.[33]

As another example, Primrose Schools—which offers early-childhood education franchises—has targeted downtown neighborhoods that lack quality early-education facilities.[34] Similar to Taco Bell, Primrose Schools has adapted its offering to fit within cramped urban areas: it has constructed multi-level structures instead of single ranch-style buildings and offers rooftop green areas for children to play on rather than traditional playgrounds.[35] Moreover, in congruence with the earlier discussion about maximizing community buy-in, Primrose Schools has targeted tightly knit communities in desperate need of early-childhood education facilities. Both concepts reflect

28. *See* MSA Worldwide, *supra* note 17 (arguing that marketing strategies should be tailored to local markets).

29. *See id.* (expressing the caveat that while franchisors should be flexible with their concepts, they should be careful to avoid lowering system standards).

30. Peter Romeo, *Inside Taco Bell's New Designs*, Rest. Bus. (May 17, 2016), https://www.restaurantbusinessonline.com/inside-taco-bells-new-designs.

31. *See* Tom Kaiser, *Taco Bell + booze – burbs = Cantina*, Franchise Times (Dec. 23, 2015), https://www.franchisetimes.com/January-2016/Taco-Bell--booze--burbs--Cantina [hereinafter *Taco Bell*] (introducing Taco Bell's "Cantina" concept, which opened its first location in Chicago's Wicker Park neighborhood in September 2015). *See generally* Tom Kaiser, *Introducing The Urbane Franchisor*, Franchise Times (Jan. 26, 2016), https://www.franchisetimes.com/news/January-2016/Introducing-the-Urbane-Franchisor [hereinafter *Urbane Franchisor*] (providing background information on urban franchising).

32. *Taco Bell*, *supra* note 31.

33. *Id.*

34. *See* Karsten Strauss, *How Primrose Schools Entered the Franchising of Early Education*, Forbes (June 1, 2018), https://www.forbes.com/sites/karstenstrauss/2018/06/01/how-primrose-schools-entered-the-franchising-of-early-education/#421299605bc9 (discussing Primrose Schools' strategy for downtown franchising). *See generally Urbane Franchisor*, *supra* note 31 (providing background information on urban franchising).

35. *Urbane Franchisor*, *supra* note 31.

the importance of understanding local markets and adapting the franchise concept to meet the desires of those markets, which is especially crucial in inner-city areas.

C. *Additional Operational Considerations for Downtown Stores*

In addition to the general need to evaluate a franchise concept for inner-city expansion, there are a number of specific considerations associated with bringing a business downtown. First and foremost, franchisors must keep in mind cost and expense considerations. As compared to their suburban counterparts, inner cities typically have higher costs for "water and other utilities, workers' compensation, health care, insurance, permitting and other fees,[36] real estate and other taxes,[37] OSHA compliance, and neighborhood hiring requirements."[38] While each of these costs are implicated at different levels—for example, workers' compensation fees are imposed statewide and property insurance is localized—they can be perceived to disproportionately impact inner-city markets.[39] These costs may affect wages and other operating expenses of franchisees.[40] Similarly, inner cities tend to include stricter governmental regulation, which drives up building and other costs and slows down development at nearly all stages.[41]

As a corollary to the increased costs associated with inner-city areas, franchisee access to debt and equity capital can be a significant barrier to franchising. Equity capital can be more difficult to come by for some inner-city franchisees, who may be from traditionally marginalized racial or ethnic groups or from lower socioeconomic levels.[42] With respect to debt capital, it is an unfortunate fact that many inner-city businesses still suffer from poor access to debt financing because large banks have historically neglected inner-city businesses, anticipating an inability to succeed.[43] Transaction costs

36. Michael E. Porter, *The Competitive Advantage of the Inner City*, Harv. Bus. Rev. 18 (May–June 1995), https://hbr.org/1995/05/the-competitive-advantage-of-the-inner-city. "Restrictive licensing and permitting, high licensing fees, and archaic safety and health regulations create barriers to entry into the very types of businesses that are logical and appropriate for creating jobs and wealth in the inner city." *Id.* at 19.

37. Porter, *supra* note 36, at 18. "It is an unfortunate reality that many cities—because they have a greater proportion of residents dependent on welfare, Medicaid, and other social programs—require higher government spending and, as a result, higher corporate taxes. The resulting tax burden feeds a vicious cycle—driving out more companies while requiring even higher taxes from those that remain." *Id.* at 19.

38. *Id.* at 18.

39. *See id.* at 19 (arguing that increased business costs disproportionately impact inner cities).

40. *See id*. (explaining the impact of increased costs).

41. *See id.* ("Cities have been reluctant to challenge entrenched bureaucracies and unions, as well as inefficient and outdated government departments, all of which unduly raise city costs. Finally, excessive regulation not only drives up building and other costs but also hampers almost all facets of business life in the inner city, from putting up an awning over a shop window to operating a pushcart to making site improvements. Regulation also stunts inner city entrepreneurship, serving as a formidable barrier to small and start-up companies.").

42. *See id*. at 21–22 (noting some inner-city franchisees may lack the extensive personal or family savings required to establish a franchise).

43. *See id.* (identifying gaps in availability of debt capital in inner-city markets).

associated with small-business lending can be high relative to the smaller loan amounts.[44] Fortunately, the federal government has implemented programs to help ease the strain on small-business owners. "As a result of legislation like the Community Reinvestment Act, passed in order to overcome bias in lending, banks have begun to pay much more attention to inner-city areas."[45] In addition, Small Business Administration 7(a) loans are an attractive option for banks and franchisees alike as they are guaranteed by the Small Business Administration and offer flexible terms and low interest rates.[46]

In short, franchising in inner-city markets presents a number of general considerations for franchisors to keep in mind. Prominent among those is the importance of examining the conditions of local markets, which behave differently from traditional suburban markets. In addition, success in urban areas requires the operational flexibility to adapt to changing circumstances. Franchisors should strive to work closely with local community residents and governmental authorities to establish a lasting footprint.

II. Real Estate Considerations

Real estate is one of a handful of considerations noteworthy enough to warrant its own discussion. Historically, real estate has been one of the most important aspects of a successful inner-city franchise—a franchisee may have outstanding operational knowledge of a franchise concept, but if the franchise itself is located in a poor trade area, the franchisee may not succeed.[47] Given the fundamental differences between suburban and inner-city markets, franchisors should think carefully about the territories that they grant to franchisees and the real estate factors that they consider when approving franchised locations, as the data supporting standard real estate factors—for example, population density, foot traffic, retail space, property values, and so on—may vary greatly. Accordingly, this section will explore various considerations related to downtown real estate, with an emphasis on the strategies available to franchisors. Primarily, franchisors can either seek out prime, expensive spaces to create one-of-a-kind locations, or they can settle on underdeveloped downtown areas that offer more affordable land, but potentially higher development costs.

A. *Unique Franchised Locations in Downtown Areas*

Not only do all downtown areas differ from one another, but the various neighborhoods within each urban area vary greatly from one to the next. "A

44. *See id.* (explaining potential causes of lower availability of debt capital).
45. *Id.* at 21.
46. *See generally* U.S. Small Bus. Admin., https://www.sba.gov/funding-programs/loans (last visited Feb. 6, 2019) (offering background information related to Small Business Administration 7(a) loans).
47. However, traditional brick-and-mortar locations are increasingly giving way to franchises that may only have an online presence.

ride through a large U.S. city can seem like a visit to the United Nations, passing through neighborhoods whose signs and languages change by the minute."[48] Franchise companies should keep in mind that many downtown regions contain numerous historical buildings, and local governments may prohibit franchisees from building out certain locations into the standardized designs often required by franchisors.[49] In other words, not all city units may be identical—what works well in a strip mall or stand-alone unit in a suburban vanilla box may not work in a decades-old building in a downtown area. To that end, franchisors may have to reconsider design elements so their concept fits visually in a given space.[50] Although reconfiguring design and structural elements may be a hurdle, some innovative build-outs can result in lower overhead costs; reduced space means fewer employees, less equipment, smaller signage, and the need to support different operating platforms, among other things. As a consequence, inner-city businesses can drive "extraordinary sales per square foot, especially for carry-out [and delivery], which [are] extremely popular for on-the-go city residents."[51]

In addition to the reduced costs, trendy urban spaces may serve to increase customer counts. Millennials increasingly gravitate toward downtown urban areas, often seeking out trendy, innovative concepts.[52] Arby's is a prime example of a franchisor adapting to urban real estate by building a sprawling three-story, 5,000-square-foot restaurant in a 100-year-old building in the heart of Manhattan.[53] To create a footprint in the ultra-competitive downtown area, Arby's discarded its cookie-cutter suburban layout and curated a design unique to the specific Manhattan location.[54] The restaurant features a "shotgun-style main level, a guest mezzanine over the back half of the store, and a full basement that also serves as a crewmember break room, dry storage and full-service catering kitchen to replace those drive-thru dollars the brand typically relies on in suburban locations."[55] In addition, the company improved its capacity to handle catering orders—which have higher demand in downtown areas—by reducing its back-of-house area by twenty percent when compared to its suburban locations.[56] Similarly, Primrose Schools, discussed earlier in Section II, uniquely embraces urban spaces by putting "its playground on a massive rooftop [that is] fun for kids and is off the street to

48. Eddy Goldberg, *The Growing Potential of the Urban Market*, FRANCHISING.COM (Nov. 7, 2006), https://www.franchising.com/articles/the_growing_potential_of_the_urban_market.html.

49. *See id.* (arguing that franchisors should be flexible with store layouts given the unique nature of downtown buildings).

50. *See id.* (encouraging franchisors to develop new design concepts for downtown stores).

51. *Id.*

52. *See generally* Tom Kaiser, *How Arby's Cracks the Big City Code*, *in the Urbane Franchisor*, FRANCHISE TIMES (July 25, 2017), https://www.franchisetimes.com/August-2017/How-Arbys-cracks-the-big-city-code-in-The-Urbane-Franchisor [hereinafter *Arby's*] (explaining that city-dwelling millennials prefer trendier concepts).

53. *Id.*

54. *Id.*

55. *Id.*

56. *Id.*

alleviate parental safety concerns."[57] By adapting to the unique qualities of inner-city real estate options, franchisors can create one-of-a-kind locations and remain true to their system standards.

B. *Underdeveloped Real Estate in Inner Cities*

As noted earlier, franchisors can take two strategies when considering a move downtown—on one hand, they can seek out more expensive, prime pieces of real estate to establish statement stores; on the other hand, they can seek out underdeveloped areas, which offer reasonable prices per square foot. Underdeveloped inner-city neighborhoods present an opportunity to find locations at lower costs compared to traditional locations.[58] Furthermore, as cities revitalize their downtown areas, companies are increasingly moving into neighborhoods previously reserved for factories and warehouses.[59] These neighborhoods provide large spaces at more reasonable prices, which are often located in easy-to-access areas near public transportation.[60]

Conversely, vacant property in inner cities may not be economically usable. Numerous federal, state, city, and local governmental agencies have extraordinary control over land and development, which may result in increased costs for developers who attempt to assemble several small vacant lots into usable sites.[61] Even once the land is acquired, development, environmental cleanup, and litigation can be extremely expensive.[62] Furthermore, the costs of building downtown can be much higher than in the suburbs due to logistics, negotiations, the requirement to use trade unions, and city regulations including zoning, city codes, permitting, and inspections.[63] Perhaps most prohibitive is the amount of time that these steps can take.[64]

Overall, real estate in downtown markets can be a mixed bag. Underdeveloped neighborhoods often offer cheaper real estate with unique designs and layouts—provided a franchisor is willing to take the time to

57. *The Urbane Franchisor*, *supra* note 31.

58. *See* Seid & Ainsley, *supra* note 1 (arguing that one of the main competitive advantages of inner-city markets is the existence of underdeveloped real estate).

59. *See id.* (noting that existing real estate is getting repurposed for franchise concepts).

60. *See id.* (explaining that former warehouses and factories provide opportunities for franchise expansion).

61. *See* Porter, *supra* note 36, at 17 (identifying hurdles to real-estate development in inner cities). "For example, development of the Jeffrey Plaza shopping center in Chicago's South Side required government efforts over eight years to assemble 21 contiguous parcels. Similarly, attempts to rebuild South Central Los Angeles after the 1992 riots have been hampered because only 9 of 200 vacant or underutilized properties are larger than one acre." *Id.*

62. *See id.* at 18 (discussing costs associated with inner-city real-estate development); *see also* Tom Kaiser, *The Urbane Franchisor Wonders if Philly Pretzel Can Make It There*, Franchise Times (Dec. 18, 2018), http://www.franchisetimes.com/January-2019/The-Urbane-Franchisor-wonders-if-Philly-Pretzel-can-make-it-there [hereinafter *Philly Pretzel*] (exploring whether cost of downtown real-estate development is prohibitive for franchise expansion).

63. *See* Porter, *supra* note 36, at 18 (comparing costs in suburban markets and inner-city markets).

64. *See id.* ("Managers interviewed in Boston, Los Angeles, and Chicago expressed frustration with the three-year to five-year waiting periods necessary to obtain the numerous permit and site approvals required to build, expand, or improve facilities.").

design and construct a restaurant that visually matches those spaces. At the same time, the steps required to acquire, develop, and construct buildings in these underdeveloped areas can make the costs potentially prohibitive. And, of course, given the density and competitive nature of more developed downtown areas, real estate can be quite expensive. Nevertheless, the opportunities can be attractive to franchisors due to the prime location, unique layouts, potential for high sales per square foot, and the number of impressions created by the density of foot and vehicular traffic. Franchisors looking to expand into urban markets should keep these considerations in mind, as they all will have an impact on franchisee success.

III. Franchisee and Employee Considerations

To find lasting success within inner-city markets, franchisors should, as a priority, take steps to identify and attract strong franchisees who understand the local markets and encourage franchisees to find employees who will support and advocate for the brand within their communities. Many urban areas may be unfamiliar with certain franchise concepts. For those concepts that do have existing brand recognition, local community members may not fully trust the intentions of franchisors expanding into their communities. Once franchisors get past those initial barriers to entry, they may find that inner-city markets are full of residents who are both brand-conscious and brand-loyal.[65]

A. *Recruiting Well-Qualified Franchisees*

As with suburban markets, successful urban franchising starts with recruiting the right franchisees. To find well-qualified franchisees, franchisors may have to reevaluate their traditional methods of franchisee search and selection.[66] It may be tempting for franchisors to seek out franchisees interested in remote ownership; that is, those individuals living in the suburbs but operating franchises in downtown areas. Franchisors who have seen success expanding into inner-city markets, however, have paired local franchisee candidates with available capital and other resources unique to their communities.[67] As noted earlier, franchisors should be careful not to lower selection or operating standards, which would be counterproductive to a successful relationship.[68] With that in mind, franchisors should be wary of the challenges of trying to find franchisees within inner-city markets. Unfortunately, given the higher rates of poverty in inner cities, franchisors may struggle to

65. *See* Jeffrey Steele, *Franchise Path Can Ease Entry*, Chicago Tribune (Apr. 27, 1994), https://www.chicagotribune.com/news/ct-xpm-1994-04-27-9404270078-story.html (arguing that many inner-city residents are as brand-loyal as their suburban counterparts).

66. *See* MSA Worldwide, *supra* note 17 (emphasizing the importance of flexibility in franchisee recruitment strategies).

67. *See generally id.* (identifying strategies for success in acquiring franchisee in inner-city communities).

68. *See id.* (cautioning franchisors against lowering system standards to east expansion).

find franchisees who live in the market and have the capital, business experience, and appetite for risk required to start a franchise.[69] When compared to suburban markets, franchisors may have to engage a greater number of prospects to find the ideal franchisee.[70] Patience and collaboration with local communities, governmental agencies, and inner-city revitalization projects will be key to tracking down well-qualified candidates. Franchisors must hold a firm belief in the success of their units in inner-city markets and must demand the same from their franchisees. By combining a genuine interest in the local communities with well-recruited and well-qualified franchisees, franchisors will set themselves up for success.

Nevertheless, the real or perceived inexperience of franchisees may have a negative impact on a franchisor's expansion strategy. Preliminarily, potential franchisees in inner cities may have less experience analyzing and negotiating contracts than suburban franchisees, which could result in overlooked or ignored contract terms.[71] In addition, they may have trouble comparing other opportunities and could end up in an unfavorable business arrangement.[72] The unfortunate truth is that due to the lack of both capital and available franchise concepts, many prospects are likely to be lacking extensive franchise business experience.[73] Although franchisors should not negotiate against themselves during the sales process, companies should keep in mind that they may be dealing with prospects who have less experience than their suburban counterparts or who are entrepreneurial enough to adapt to the changing needs of a downtown micro-market, yet able and willing to follow what they might believe are too rigid of system standards. Accordingly, franchisors should allocate additional time to search for and vet potential franchisees, and should work closely with prospects to ensure a franchise relationship is beneficial for all parties.

B. *Hiring and Training Inner-City Employees*

Once a franchisee has been selected, the franchisor should work closely with the franchisee to educate and empower it to recruit the right personnel. Regarding labor and employment, the existing shortages of retail establishments present a largely untapped labor market from which franchisees may be able to draw. Many residents living in inner-city markets must travel away

69. *See* Rob Kaiser, *Inner City Looks to Be Franchising's Frontier*, Chicago Tribune (Dec. 23, 2002), https://www.chicagotribune.com/news/ct-xpm-2002-12-23-0212230004-story.html (highlighting some of the challenges posed by inner-city franchising).

70. *See id.* (identifying potential strategies for inner-city franchisee recruitment). "To find one franchisee, he noted, most franchise companies talk with 40 to 100 prospects. For the inner-city partnership program, Chandler said, 'It's more than 200, probably several hundred.'" *Id.*

71. *See* Leigh et al., *supra* note 27, at 15 (noting that inexperienced franchisees may have trouble interpreting franchise agreements).

72. *See id.* (explaining that the inexperience of inner-city franchisees may adversely impact urban growth).

73. *See id.* (pointing out that many inner-city franchisees lack extensive franchise experience).

from home to find jobs, so local opportunities benefit everyone.[74] Nevertheless, franchisors may face a number of challenges related to hiring and training and, unfortunately, the perception of a less skilled labor force.[75] To combat these challenges, franchisors should encourage their franchisees to find well-qualified employees who will be loyal and dedicated to the brand.[76] In addition, franchisors may need to rethink their training programs to better train inner-city franchise employees. For example, some retailers who have found success in inner cities have dedicated additional training resources and offered incentives to increase retention and avoid turnover.[77] As with franchisees, management-level employees within franchised units must share in the franchisor's belief that their concept will be successful within the local communities. "Top management must allocate the necessary resources, set high operational standards, and institute practices that capitalize on the market opportunity and position inner-city stores to succeed. Franchisors must hire qualified, profit-focused in-store managers and hold them to the same performance expectations as managers in other store locations."[78]

A franchise will struggle to achieve long-term success without emphasizing buy-in by both the franchisees and their employees. Franchisors should avoid making the hiring decisions on behalf of franchisees, but franchisees will undoubtedly look to the franchisor for guidance in recruiting, hiring, training, and retaining effective personnel. Thus, when considering an expansion into inner-city markets, franchisors should keep in mind that they may have to pay extra attention to their brand standards that will help franchisees focus their hiring and training, or develop suggestions to aid those franchisees.

IV. Crime and the Perception of Crime

Crime and the perception of crime are certainly elements franchisors must deal with in suburban markets, but the unfortunate reality is that crime rates tend to be higher within inner-city areas.[79] Particularly, franchisors must contemplate criminal acts that threaten both employees and customers. To that end, successful franchising in urban areas necessitates robust and effective management of both actual crime and the perception of crime. "The perceived magnitude of crime in inner cities may be exaggerated, partly because of excessive and perhaps myopic coverage by the media of criminal activity

74. *See* Seid & Ainsley, *supra* note 1 (arguing that inner-city residents will benefit from local businesses).

75. *See generally* Boston Consulting Group, *supra* note 2 (identifying employment challenges facing franchisors in inner-city markets).

76. *See id.* at 13 (suggesting that success in inner-city markets depends on franchisees hiring well-qualified employees from the local community).

77. *See id.* (stressing the importance of effective hiring and training strategies).

78. *Id.* at 14.

79. *See generally* Boston Consulting Group, *supra* note 2 (discussing crime rates in inner cities).

in these areas."[80] While recent statistics have marked a decrease in violent crime nationwide,[81] crime rates remain higher in downtown areas relative to the suburbs.[82] As a consequence, franchisors should work to develop and recommend suggested strategies to franchisees for combatting crime and the perception of crime. In many companies that already have an inner-city presence, in-store managers are encouraged to work closely and effectively with law enforcement officials and community groups.[83] Moreover, many local units outfit their stores with extra lighting, surveillance, and private security personnel.[84] Franchisors should consider the unique elements present in inner-city markets and account for the potentially higher crime rates, or at least consider creating an environment that emphasizes security to avoid even a high-crime perception.

Notably, franchisors should never assume a duty to protect employees and patrons, and they must avoid implications of joint-employer liability. To that end, franchisors should present certain safety policies—particularly those centered around staffing levels and employee behavior—as recommendations rather than requirements. In much of the litigation across the United States concerning the issue of crime in franchised outlets, many courts have declined to hold franchisors liable for failing to prevent crime in their franchised units. For example, in *Kerl v. Dennis Rasmussen, Inc.*,[85] the victim of a shooting perpetrated by an employee at a franchised unit brought a negligence action against the franchisee and the franchisor under a theory of vicarious liability.[86] The case was appealed to the Wisconsin Supreme Court, where the court held, as a matter of first impression, that the franchisor did not have control or the right to control the franchisee's supervision of its employees.[87] Without the requisite level of control, the court declined to hold the franchisor liable for the franchisee's alleged negligence.[88] Additionally, in a pair of cases out of the Circuit Court of Cook County, Illinois, the court considered whether the franchisor had voluntarily undertaken

80. *Id.* at 16.

81. Boston Consulting Group, *supra* note 2 ("Between 1989 and 1996, the total crime rate fell by 46 percent in New York, by 33 percent in Boston, and by 25 percent in Miami.").

82. *See id.* at 16 (discussing crime rates in inner cities); *see also* Kim Zeuli, *The Big Impact of Small Businesses on Urban Job Creation: Evidence from Five Cities*, The Initiative for a Competitive Inner City 13 (Oct. 2016), http://icic.org/wp-content/uploads/2016/10/JPMC_R1_BigImpact_FINAL_forpost.pdf (same).

83. *See* Boston Consulting Group, *supra* note 2, at 16 (discussing strategies for dealing with higher crime rates); *see also* Zeuli, *supra* note 82, at 13 (same).

84. *See* Boston Consulting Group, *supra* note 2, at 16 (discussing strategies for dealing with higher crime rates).

85. Kerl v. Dennis Rasmussen, Inc., 682 N.W.2d 328 (Wis. 2004).

86. *Id.* at 331.

87. *Id.*

88. *Id.* at 332; *see also* Wu v. Dunkin' Donuts, Inc., 105 F. Supp. 2d 83, 84 (E.D.N.Y. 2000), *aff'd.*, 4 F. App'x 82 (2d Cir. 2001) (finding that the franchisor was not vicariously liable for security lapses associated with assault of a franchisee's employee because the franchise agreement did not give the franchisor considerable control over security).

to provide safety to franchisees and consequently breached that duty.[89] In both cases, the court declined to find the franchisor liable, despite the fact that the franchisor in both cases encouraged its franchisees to adopt crime-prevention strategies.[90] Finally, in *VanDeMark v. McDonald's Corp*,[91] a restaurant worker brought both a negligence and vicarious liability claim against the franchisor after the restaurant employee was attacked while working.[92] There, the New Hampshire Supreme Court found that the franchisor did not attempt to provide security to the franchisee's employees and therefore did not assume a duty to the worker.[93] Moreover, the court found the franchisor did not assume control over the franchisee's security measures and rested its decision on the fact that the franchisor simply made recommendations rather than mandating specific actions.[94] With these decisions in mind, franchisors should prepare their crime-prevention strategies with caution, emphasizing that they are presented to franchisees as suggestions and recommendations, rather than requirements. In doing so, franchisors can help make franchisees feel comfortable, which will result in the franchisee's employees and customers feeling safe and secure as well.

In addition to violent crime, inner-city markets experience increased levels of graffiti and vandalism. Graffiti, in particular, is an especially burdensome nuisance because it can quickly return after walls and windows are cleaned, repainted, or replaced.[95] In 1992, the City of Chicago made it illegal to purchase spray paint within city limits due to the nuisance posed by graffiti—a ban which exists to this day.[96] Similarly, vandalism to store signage and premises presents a potentially costly burden to franchisees who must repair or replace any damage to their units. In response, franchisors should consider the degree to which they should enforce their image and system standards on urban franchisees. On one hand, uniformity of brand standards across the system is essential to a franchise company's success—thus, many franchisors may want inner-city locations to maintain the same store appearance as suburban locations, regardless of the potentially increased rate of crime; although doing so may result in higher maintenance costs. On the other hand, franchisors can take a flexible approach and relax image standards slightly to account for the increased problems associated with graffiti and vandalism, or they could even intentionally decorate with murals to preempt or incorporate any graffiti. Understandably, these exceptions may

89. Chelkova v. Southland Corp., 771 N.E.2d 1100 (Ill. App. Ct. 2002); Castro v. Brown's Chicken & Pasta, Inc., 732 N.E.2d 37 (Ill. App. Ct. 2000).

90. *Chelkova*, 771 N.E.2d at 1110; *Castro*, 732 N.E.2d at 40.

91. VanDeMark v. McDonald's Corp., 904 A.2d 627 (N.H. 2006).

92. *Id.* at 629.

93. *Id.* at 633.

94. *Id.* at 636.

95. *See generally* Fran Spielman, *Not So Fast: Aldermen Won't Relax Spray Paint Ban to Help Store Owners Just Yet*, Chicago Sun-Times (July 18, 2018), https://chicago.suntimes.com/news/chicago-spray-paint-ban-relaxed-edward-burke-matt-oshea (discussing challenges posed by graffiti in downtown areas).

96. *See generally id.* (discussing Chicago's spray paint ban).

make it harder to enforce uniformity across the system. Thus, it may be beneficial for franchisors to take a hybrid approach; as noted earlier, operational flexibility is a crucial component to success in inner-city markets.

Conclusion

Franchisors' investments in inner-city markets may create some additional risks and involve considerations not as prominent in more traditional suburban markets, but when evaluating expansion options, franchisors would do well to balance those considerations and both the real and perceived risks, especially as compared to those presented by international expansion or other expansion methods. The needs and desires of community residents can be unpredictable, and the barriers to entry are sometimes steep—governmental regulations can be cumbersome, and capital can be scarce. Nevertheless, expansion into these areas presents a tremendous opportunity for franchisors to tap into markets with enormous buying potential. To do so successfully requires a careful evaluation of the viability of the concept in a particular urban area along with flexible standards related to a number of different aspects of the franchise system, including operations, real estate, and training. To maximize success in these regions, franchisors must combine self-awareness of their concept with a keen understanding of the unique characteristics of the local markets.