SCALING SOCIAL ENTERPRISES THROUGH FRANCHISE MODELS: RETHINKING SOCIAL FRANCHISE AGREEMENTS

Deborah Burand, David Koch, and Katy Yang*

Harper wove together innovative business practices and social entrepreneurship to create a truly pioneering franchise system in the late 1800s.[1]

I. INTRODUCTION

They call her the "mother of franchising," and, if Congressman Joseph D. Morelle of New York has his way, she soon may have her own commemorative postage stamp. That woman is Martha Matilda Harper.

A domestic servant from the age of seven until her early 30s, Harper opened the Harper Method Shops and School, a hair and skin care store, in the 1890s.[2] At a time when launching new entrepreneurial ventures was largely the province of men, Harper developed a worldwide franchise system of female-owned hair salons that trained its female franchisees in the "Harper Method" of beauty, which focused on providing consistent, high-quality customer service.[3] As Congressman Morelle put it in July 2019 when he urged his Congressional colleagues to join him as co-sponsors in a resolution calling for the issuance of Harper's commemorative postage stamp, "[t]hrough her commitment to ensuring that the first one hundred salons would be opened by economically disadvantaged girls, Harper helped transform the lives of other women."[4]

If it worked for Martha Matilda Harper nearly 130 years ago, couldn't franchising practices do the same for other ambitious social entrepreneurs today? This article explores this question by examining the opportunities that franchising practices offer to social enterprises that aim to scale while pursuing both profits and purpose. More specifically, this article examines *why (and why not)* a franchise model might be attractive to social enterprises that seek to scale as compared to alternative growth strategies. Then it analyzes *how* social enterprises contract to

---

* Deborah Burand is a Professor of Clinical Law at NYU School of Law. David Koch is a founding partner of the law firm Plave Koch PLC, a boutique firm specializing in franchising and licensing. Katy Yang is an associate of the law firm RPCK Rastegar Panchal, an international boutique law firm focused on providing highly-tailored and innovative solutions to investors, entrepreneurs and growth enterprises around the world, and is a former Fellow of the Grunin Center for Law and Social Entrepreneurship at NYU School of Law. The authors thank NYU law students Julia Chen, Zachary Krooks, and Rebecca Papilsky for their helpful research support in the development of this article. Any errors that remain, however, are solely those of the authors.

[1] Letter from Congressman Joseph D. Morelle to fellow member of Congress (July 23, 2019), available at http://dearcolleague.us/2019/07/seeking-original-cosponsors-to-honor-the-mother-of-franchising/.

[2] *See* NAT'L WOMEN'S HALL OF FAME, *Martha Matilda Harper*, https://www.womenofthehall.org/inductee/martha-matilda-harper/.

[3] *See* Press Release, Int'l Franchise Ass'n, Rep. Morelle Introduces Resolution for "The Mother of Franchising" (July 26, 2019), available at https://www.franchise.org/media-center/press-releases/rep-morelle-introduces-resolution-for-the-mother-of-franchising.

[4] Letter from Congressman Joseph D. Morelle, *supra* note 1. *See also* Press Release, Int'l Franchise Ass'n, *supra* note 3.

create franchise relationships capable of supporting the dual pursuit of financial and social returns. In doing so, this article draws on the theory of incomplete contracting to explain and illustrate the approaches and challenges that come with aligning interests of social franchisors and their franchisees and maintaining that alignment over time.

It is this last topic—how to create durable franchise relationships that advance desired social and environmental impact, as well as financial objectives, while aligning the interests of franchisors and franchisees around these double bottom lines (social/environmental and financial returns)—that is at the heart of this discussion. This article looks at the form and structure of franchise agreements that currently are used in commercial franchising and compares those with the contractual relationships being forged by social franchises operating in the United States and beyond. It concludes with suggestions for how franchise agreements might be tailored to help both social franchisors and franchisees flourish while scaling both profits and purpose.

II. DEFINITIONAL ISSUES

Harper's pioneering franchise legacy continues to this day. In the United States, over 700,000 franchise businesses currently employ nearly 8 million people and contribute more than $404 billion to United States GDP.[5] Despite these numbers, academic literature has paid scant attention to the opportunities that franchising presents to social enterprises that, like other small and growing businesses, aim to scale.[6] Legal scholarship on this topic is sparser still.[7]

Part of the challenge confronting an academic examination of the application of franchise models to social enterprises is a definitional one. Just parsing the terms used in the title of this article, *Scaling Social Enterprises through Franchise Models: Rethinking Social Franchise Agreements*, illustrates this problem. None of the following three terms—social enterprises, franchise, or social franchise—lends itself to a straightforward and commonly agreed upon definition.

---

[5] U.S. DEP'T OF COMMERCE, FRANCHISING INDUSTRY: A REFERENCE FOR U.S. EXPORTERS 3 (2018 ed.), available at https://www.franchise.org/sites/default/files/2019-05/USCS_Franchising_Resource_Guide_2018.pdf.

[6] *See* Joseph Asemota & Theresa Chahine, *Social Franchising as an Option for Scale*, 28 INT'L J. VOLUNTARY & NONPROFIT ORGS. 2734, 2739 (2017) (published online in August 2016) (discussing a literature review of articles on social franchising that was conducted and found only four peer-reviewed articles discussing considerations for embarking on and implementing social franchising).

[7] A legal literature review of law review articles published in the United States between 2007 and 2017 that address the topics of social entrepreneurship or impact investing yielded only one law review article that considered the topic of social franchising. *See* Deborah Burand & Anne Tucker, *Legal Literature Review of Social Entrepreneurship and Impact Investing (2007-2017): Doing Good by Doing Business*, 11 WM. & MARY BUS. L. REV. 1, 66 (2019).

A. Defining Social Enterprise

First, what is meant by a "social enterprise"? As with any new concept, there can be as many definitions of social enterprise as there are would-be definers. Social enterprises can be organized as either for-profit or nonprofit organizations.[8] They can have five employees or thousands. They can work locally or globally. What they share, however, is the goal of creating value for others, not just themselves.[9] Put differently, social enterprises aim to generate positive social or environmental returns that benefit stakeholders outside of the enterprise itself, while also pursuing financial returns for the enterprise.

What social enterprises do with those financial returns, of course, will depend on their profit and mission-orientations. On the one hand, both for-profit and nonprofit social enterprises may decide to reinvest surplus financial returns into their operations, thereby becoming more financially self-sufficient and less dependent on other sources of capital for growth. On the other hand, social enterprises that are for-profit organizations may pursue financial returns not only to fuel growth, but also for distribution to their investors. Social enterprises that are nonprofit organizations, however, may use their financial returns to make donations or otherwise subsidize their non-revenue producing or less financially sustainable activities.

For the purposes of this article, we do not apply, as some do,[10] a litmus test that looks to how surplus returns are used in order to distinguish between social and commercial enterprises. Rather, when this article refers to social enterprises, we generally are describing a firm that deliberately serves two masters—profit and purpose. It is a firm that is dedicated to achieving profits while generating social/environmental returns for the good of society. In doing so, it puts achievement of its mission at the core of its business model, not as an incidental benefit.

Furthermore, the practitioner audience for this article is likely to come from a particular subset of social enterprises (and those who advise them). Namely, this article focuses on those social enterprises that not only are commercially viable with a proven track record of success, but also have the ambition and potential to scale. It is this latter point, the ambition and potential to scale, that may drive such social enterprises to consider integrating franchise practices into their business models.

---

[8] *See* Alicia E. Plerhoples, *Representing Social Enterprise*, 20 CLINICAL L. REV. 215, 220-21 (2013).
[9] *See* Alessandro Giudici et al., *Successful Scaling in Social Franchising: The Case of Impact Hub*, *in* ENTREPRENEURSHIP THEORY & PRAC. 2 (2018).
[10] For some, the distinction between commercial enterprises and social enterprises turns on how they use their surplus profits. *See, e.g.*, SOCIAL ENTERPRISE UK, *What Is a Social Enterprise?*, www.socialenterprise.org.uk (defining social enterprises as "businesses . . . set up to change the world. Like traditional businesses they aim to make a profit but it's what they do with their profits that set them apart – reinvesting it or donating it to create positive social change.").

B. Defining Franchise

Second, what is meant by a "franchise"? Those who seek to regulate franchise relationships have created their own legal definitions of what constitutes a franchise, which can vary from jurisdiction to jurisdiction.[11] Similarly, others, like the U.S. Department of Commerce, classify franchising relationships as any relationship in which a retailer operates under its supplier's trademark (sometimes called "product" or "tradename" franchising).[12]

In this article, however, we are not limiting our discussion of franchising to legal definitions or government classifications. Rather, we are focusing on the practices that typically characterize a business-format franchise. Put in its most simple terms, in a business-format franchise, one party (the franchisor) structures the business format and establishes rules for the format's processes and operations, and another party (the franchisee) operates under that format.[13] As one commentator has put it, "franchisors are in the business of figuring out how to build a better mouse-trap while franchisees are in the business of building it."[14]

Of course, this delegation of duties and differentiation of roles is what happens in many forms of business relationships, not only franchise relationships.[15] Take, for example, employment contracting, independent contracting, and much that falls in between these two forms of business relationships. It is in this "in between" state where franchising resides—as franchising is a hybrid that falls somewhere between the continuum of employment and independent contracting.[16]

This is by design because ownership and control are deliberately separate in the business-format franchise. Indeed, in the purest form of a business-format franchise, ownership fully resides in the franchisee, while control fully resides in the franchisor. But franchising often is messier than this simplistic description of the business-format franchise suggests. It is not always easy to distinguish between transactions that take place *within* firms and those that take place *between* firms, as some franchising takes place where these intra- and inter-firm borders blur.[17] Moreover, there may be a similar blurring of lines across the roles undertaken in

---

[11] *See* Philip F. Zeidman, *With the Best of Intentions: Observations on the International Regulation of Franchising,* 19 STAN. J.L. BUS. & FIN. 237, 265 (2014) (noting that in the United States, federal and state statutes have created definitions of "franchise" that are largely equivalent to each other; in contrast, some jurisdictions outside of the United States, have created broader definitions of what constitutes a franchise).

[12] *See* Gillian K. Hadfield, *Problematic Relations: Franchising and the Law of Incomplete Contracts*, 42 STAN. L. REV. 927, 933 (1990).

[13] In a business-format franchise, franchisees are not just licensed to create or distribute a product/service; rather, they also are required to comply with a set of rules that are intended to ensure consistent quality of the products/services across the entire franchise network. *See* Asemota & Chahine, *supra* note 6, at 2737.

[14] *See* Hadfield, *supra* note 12, at 958.

[15] *See id.* at 933-34.

[16] *See id.* at 931.

[17] *See* Paul H. Rubin, *The Theory of the Firm and the Structure of the Franchise Contract*, 21 J.L. & ECON. 223, 223-24 (1978).

the franchisor/franchisee relationship. In short, better mousetrap designs sometimes come from those who actually are in the business of building mousetraps.

C. Defining Social Franchise

This brings us to our last and perhaps most difficult definitional challenge—describing what is meant by the term "social franchise." Like the terms discussed above, because the business models used in social franchising can vary greatly, the term social franchise can mean many different things to different observers.[18] Therefore, we run the risk of talking past each other when comparing or analyzing social franchise models or sharing lessons learned from social franchise practices.

What is most pertinent is not the legal form the social franchisor or its franchisee takes, but, rather, the business model under which their franchise relationship operates. Indeed, the legal forms of the parties may be among the least relevant factors in ascertaining whether a franchise relationship falls within the scope of a social franchise, although an argument can be made that the legal form chosen communicates the parties' intentions to put mission first or at least on equal footing with financial considerations.[19] Much more important than legal form is how this relationship is structured and operates.

---

[18] *See* Elizabeth Crawford-Spencer & Francina Cantatore, *Models of Franchising for Social Enterprise*, 23 J. MARKETING CHANNELS 47 (2016). Crawford-Spencer and Cantatore use as the starting point for their analysis of social franchises the broad definition created by Koehlmoos and associates, which describes social franchising as:

> an adaptation of a commercial franchise in which the developer of a successfully tested social concept (franchiser) enables others (franchisees) to replicate the model using the tested system and brand name to achieve a social benefit. The franchisee in return is obligated to comply with quality standards, reports sales and services statistics, and in some cases, pay franchise fees. All service delivery points are typically identified by a recognizable brand name or logo.

Tracy Perez Koehlmoos et al., *The Effect of Social Franchising on Access to and Quality of Health Services in Low- and Middle-Income Countries (Review)*, THE COCHRANE COLLABORATION, 2-3 (2009).

[19] Some social franchisors have incorporated under one of the legal forms expressly created to house social entrepreneurial activities, such as the low-profit, limited liability company (L3C). See, for example, Jibu, a social franchise network that seeks to provide clean and affordable drinking water to high-density, under-served populations in East Africa. Jibu's founders deliberately chose to incorporate in North Carolina as a L3C, rather than an LLC, in order to signal to investors and the general public Jibu's commitment to pursuing both social impact and financial returns. *See* ALICE THAI ET AL., MAPPING THE STATE OF SOCIAL ENTERPRISE AND THE LAW: 2017-2018 2-6 (GRUNIN CTR. L. & SOC. ENTREPRENEURSHIP 2018) (available at http://www.law.nyu.edu/sites/default/files/upload_documents/Tepper%20Report%20-%20State%20of%20Social%20Enterprise%20and%20the%20Law%20-%202017-2018.pdf).

Other franchisors may choose to pursue B corporation (B Corp) certification. While not a form of legal entity, B Corp certification is granted by the nonprofit organization B Lab to companies that

Let's first describe what we are *not* addressing when we use the term "social franchise."[20] We are not examining branded distribution networks sponsored by multinational corporate brands to distribute their products either to and/or by people living at the base of the economic pyramid, such as "last mile retail" or "door-to-door" ("D2D") distribution networks.[21] The multinational corporation Unilever, for example, has actively pioneered last mile retail distribution networks for over a decade. Its Shakti program in India has trained tens of thousands of local women to act as sale agents in rural areas for Unilever products.[22] While much good can come of branded distribution networks like those of Unilever, our focus is on those franchise networks that are at least as, if not more, intent on creating positive social or environmental returns as they are on selling the products of the brand that is sponsoring the network.

Nor are we looking at nonprofit organizations that invest in commercial franchises primarily in order to fund their charitable activities. Take, for example, the nonprofit organization Washington Vocational Services that invested in an Auntie Anne's Pretzel franchise to help fund its charitable programs while also employing disabled people.[23] Here also much good can come of such a franchise

---

meet certain social and environmental performance, public transparency, and legal accountability requirements. *See* B LAB, *About B Corps* (2019), https://bcorporation.net./aboutb-corps.

Perhaps the largest and most visible example is that of Natura & Co., a Brazilian cosmetic company, which became a certified B Corp in 2014. *See* Meghan French Dunbar, *How Natura Became the World's Largest B Corp – And How It's Helping*, CONSCIOUS CO. (Jan. 5, 2016), https://consciouscompanymedia.com/ sustainable-business/how-natura-became-the-worlds-largest-b-corp-and-how-its-helping/). In May 2019, Natura & Co. announced that it was acquiring its rival, Avon Products, Inc. Both companies use a direct selling model in which independent distributors, often females, serve as brand ambassadors and sell beauty products door-to-door. *See* Priya Rao, *What Natura & Co's Acquisition of Avon Products Inc. Means for the Global Beauty Industry*, GLOSSY (May 23, 2019), https:// www.glossy.co/beauty/what-natura-cos-acquisition-of-avon-products-inc-means-for-the-global-beauty-industry (identifying challenges Avon has had in retaining committed retail distributors and noting high rates of churn among Avon retail distributors as well as representatives engaging in cross-selling other companies' products).

What remains to be seen is how Natura & Co. influences Avon Products, Inc. to engage in business practices that are consistent with B Corp certification. If Body Shop, another subsidiary of Natura, is any indication, B Corp certification might be in store for Avon too. *See The Body Shop Issues Call to Action as It Announces B Corp™ Certification*, YAHOO FIN. (Sept. 23, 2019), https://finance.yahoo.com/news/body-shop-issues-call-action-160400989.html (Body Shop is now largest woman-founded B Corp).

[20] Although we are creating our own definition of social franchise for purposes of this article, the findings and analysis that follow might very well apply to a potentially larger swathe of relationships than our limited description of social franchise networks otherwise indicates, including some of those franchise relationships that we expressly chose not to include within our definition of social franchise.

[21] *See generally* NOAH BECKWITH, INCLUSIVE BUSINESS FINANCING: WHERE COMMERCIAL OPPORTUNITY AND SUSTAINABILITY CONVERGE (ASIAN DEV. BANK 2018) (distributor-focused model of inclusive business distribution networks can meet two goals – solve last mile distribution problems by getting quality goods and services into the hands of underserved populations and also increase business opportunities for the distributors).

[22] *See* UNILEVER, *Sharing Our Expertise in Last-Mile Distribution* (Oct. 4, 2018), https://www.unilever.com/news/news-and-features/Feature-article/2018/sharing-our-expertise-in-last-mile-distribution.html (describing Unilever's last-mile distribution networks).

[23] *See* Thomas Pitegoff, *Franchising for the Greater Good*, LAW360 (June 3, 2015), https://www.

strategy. Operating a commercial franchise may generate a steady income stream that will subsidize the work conducted by the nonprofit franchisee. Operating a commercial franchise also may provide employment opportunities or products/services that are consistent with or even advance the nonprofit franchisee's mission. But these benefits are incidental to the profit-generating goals of the commercial franchise. In contrast, in this article, we are focusing on franchise models where the social franchise network itself is the means by which desired social and environmental goals are to be achieved.

Also falling outside of our analysis are those nonprofit organizations that adopt a franchise-like model to create and support other nonprofit organizations that are operating under a shared brand or trademark. This can take the form of creating affiliation or licensing agreements as the founding nonprofit attempts to assert control over affiliates through means other than equity ownership in order to ensure that they protect the founding nonprofit's brand and know-how. This model is particularly useful where it is important to the affiliated enterprises to operate as nonprofit organizations and thereby enjoy tax-exempt status within their own respective jurisdictions. FINCA International, a global microfinance network, used this model before it transformed its network of affiliated microfinance institutions from nonprofit organizations with microcredit-related products into for-profit, deposit-taking, regulated financial institutions.[24] At that point, FINCA vertically integrated its global network and turned these transformed institutions into subsidiaries of the FINCA holding company. This allowed FINCA to assert brand control and quality standards on its affiliated organizations through its controlling equity ownership, rather than primarily through contractual arrangements such as funding and affiliation/licensing agreements.

So, having narrowed the scope of franchise networks for analysis, what is included in our definition of social franchise?

The focus of this article is on those social franchise networks that are sponsored by a social enterprise in order to generate social and/or environmental returns through the operation of a franchise network. In short, what distinguishes the social franchise networks that this article is most concerned with is the franchise network's primary focus on creating social and/or environmental benefits, not merely as a by-product or as an incidental, albeit welcome, benefit.[25]

---

law360.com/articles/663506/franchising-for-the-greater-good (citing example of Washington Vocational Services and its Auntie Anne's Pretzel franchise); *see generally* Crawford-Spencer & Cantatore, *supra* note 18, at 52.

[24] During this pre-transformation stage, FINCA exerted control over its global network of affiliated, non-profit microfinance institutions through a combination of levers – governance (obtaining board seats within FINCA affiliates), funding agreements (instilling performance covenants in the grant and loans it extended to FINCA affiliates), and affiliation agreements (providing operating guidelines, imposing reporting requirements and licensing the use of the FINCA brand to FINCA affiliates). One of the authors of this article, Prof. Burand, oversaw and, at times, participated in the exercise of many of these levers of affiliate control during her tenure at FINCA from 2001-2004, during which time she served as the transformation manager, acting technical assistance director, and then director of the capital markets group of FINCA International.

[25] This distinction also is often made to distinguish social entrepreneurs from more commercial

A secondary, but important, goal of these social franchise networks is to reach financial sustainability. At a minimum, this means that the network seeks to generate sufficient profits to operate on a financially sustainable basis—at least for the franchisees.

Borrowing from literature that aims to differentiate among various forms of social enterprises, we suggest that social franchise networks, like social enterprises, can be categorized according to how and where they seek to generate, and then distribute, financial and social/environmental returns.[26] This distinction has led us to identify two broad categories of social franchise networks: (1) trade-off networks, and (2) lockstep networks.

1. Trade-Off Franchise Networks

A trade-off franchise network, as envisioned here, engages in franchising in order to generate social/environmental returns, but its defining feature is that it is willing to trade off some (or all) of its financial returns for desired social/environmental returns. The key questions presented by a trade-off franchise network are (1) who decides whether to make this trade off, and (2) who bears the

---

entrepreneurs. *See, e.g.*, Roger L. Martin & Sally Osberg, *Social Entrepreneurship: The Case for Definition*, STAN. SOC. INNOVATION REV. (2007), https://ssir.org/articles/entry/social_entrepreneurship_the_case_for_definition ("What distinguishes social entrepreneurship is the primacy of social benefit . . . .").

[26] We are borrowing heavily from, and then adapting, a typology that explains the range of enterprises that may characterize themselves as social enterprises. That typology divides social enterprises into three categories: profit-generating, trade-off, and lockstep. *See* Paul Cheng & Joe Ludlow, *The Three Models of Social Enterprises: Creating Social Impact Through Trading Activities: Part 1*, VENTURESOME (Jan. 2008), https://www.cafonline.org/docs/default-source/about-us-publications/venturesome3modelsofsocialenterprise_part1jan2008.pdf.

Others have focused on charting hybrid organizations, like social enterprises, that seek to generate both social and economic value according to three main factors: (1) the extent that their activities relate to motive (mission or profit-seeking), (2) the interests to which they are accountable (shareholders or stakeholders), and (3) their use of income (whether they reinvest or distribute income outside the enterprise). *See* Crawford-Spencer & Cantatore, *supra* note 18, at 49 (citing frameworks applied by Alter (2010), Justo et al. (2009), Nicholls (2006), and Peredo and McLean (2006)).

Applying this three-factor framework originally used for bucketing social enterprises to now categorizing social franchise networks, Crawford-Spencer et al. divide social franchises into three categories: (1) traditional social franchising (meaning a nonprofit franchising model with a nonprofit franchisor), (2) microfranchising (meaning a nonprofit franchising model that also employs a nonprofit franchisor), and (3) social franchise investment (meaning a franchising model with a for-profit franchisor and nonprofit franchisees). *See* Crawford-Spencer & Cantatore, *supra* note 18, at 49-52.

Another typology used to differentiate among models of inclusive distribution networks looks to the primary stakeholders to be engaged – consumer, producer, supplier, distributor, and employee. For example, a consumer-focused distribution network may target underserved or excluded customers, whereas a distributor-focused model may target overlooked or marginalized populations at the base of the economic pyramid. Yet, even here, this differentiation by stakeholder engagement can result in fuzzy distinctions, as some networks combine multiple engagement goals. *See* BECKWITH, *supra* note 21, at 10.

financial cost (or loss) that comes with such a trade? Is it the social franchisor, the franchisee, or both?

In our experience, it is most likely the social franchisor, not the franchisee, who is willing to operate at a loss, or at least at cost, in a trade-off franchise network. Yet, there may be exceptions to this observation, particularly where the franchisee is engaging in other business activities that are unrelated (or only tangentially connected) to its involvement in the trade-off franchise so it can afford to limit its pursuit of profits at the franchise outlet. Take, for example, the franchise network sponsored by Marie Stopes International. In 2004, it turned to a social franchise model to partner with private healthcare providers around the world to deliver high-quality contraception and safe abortion services to poor communities. Often these private healthcare providers were already serving the targeted communities, so their franchise relationship with Marie Stopes International allowed them to add family planning services to an existing suite of health-related services.[27] One can imagine that in such circumstances some franchisees may realize profits, directly or indirectly, from joining this franchise network—that is, they will enjoy increased revenues that are generated both from the new family planning services they can now offer and from a customer base that is growing because of this expansion of healthcare offerings.

Trade-off franchise networks can take various forms. Two of the most common are social sector franchises and microfranchises.

a. Social Sector Franchises

What the International Franchise Association calls "social *sector* franchises" often take the form of a trade-off franchise network. Social sector franchises differ from commercial franchises in two ways: (1) type and purpose of the products and services offered by the business being franchised, and (2) profile of the target customer.[28] A social sector franchise concerns itself with selling goods or services that are affordable for a poor customer base. Often it is the target customer's relative poverty and, hence, inability to pay in full for the goods and services being distributed by the social sector franchise network that can give rise to the trade-offs that characterize this form of franchise. Consequently, franchisors engaging in a social sector franchise are "usually unable to generate the royalty

---

[27] *See* MARIE STOPES INT'L, *Our Services*, https://mariestopes.org/what-we-do/our-approach/social-franchising/; *see also* MARIE STOPES INT'L – U.S., *2018 Annual Report* (2018), https://www.mariestopes-us.org/2018-annual-report/ (characterizing itself as a social enterprise that self-generated 40% of its revenue in 2018).

[28] *See* SOC. SECTOR TASK FORCE, *Defining Social Sector Franchising* (2018), http://www.socialsectorfranchising.org/faqs.html.

and other revenue and fees necessary to independently sustain the overall business."[29]

Living Goods is an example of a social sector franchise.[30] Living Goods, a nonprofit organization, operates and trains a network of franchised health entrepreneurs (called community health workers) who go door-to-door within poor communities in emerging markets, primarily in Africa, diagnosing diseases and providing basic health counseling, while selling health-related and other household products. Its "business in a bag" model resembles, by design, Avon's distribution practices, but Living Good's community health workers sell deworming pills, not lipstick. Although Living Goods generates revenues for both the franchisor and its franchisees, it has relied on donor funding to scale its activities.[31]

b. Microfranchises

Another form of a trade-off franchise is a microfranchise network. A microfranchise network focuses on building franchisable business opportunities that are affordable for the poor entrepreneur.[32] In a microfranchise network, the franchisor's typical goal is to use franchise practices to increase poor people's access to business opportunities that can help lift them out of poverty.[33] While not all microfranchise networks will engender a trade-off of financial returns for social returns, some will.

Sometimes the terms "microfranchising" and "social sector franchising" are used interchangeably, but there are discernible differences between the goals of these two forms of franchising. Microfranchising primarily focuses on the franchisee, and only secondarily on the target customer of the franchise. Indeed, unlike social sector franchises, the target customer of a microfranchise network's goods and services may not be poor at all.

---

[29] *Id.*

[30] *See* LIVING GOODS, *Mission, Vision, and Values* (2019), https://livinggoods.org/mission-vision-and-values/. Its founder, Chuck Slaughter, was awarded the Skoll Social Entrepreneur of the Year in 2016. *See* SKOLL, *Announcing the 2016 Skoll Awards for Social Entrepreneurships* (Apr. 11, 2016), http://skoll.org/2016/04/11/skoll-foundation-announces-skoll-awards-for-social-entrepreneurship/.

[31] *See* GIVEWELL, *Standout Charities: Living Goods* (Nov. 2014), https://www.givewell.org/charities/living-goods (describing multi-million dollar funding gap Living Goods faced as it moved forward with expansion plans in Uganda and funding needs to expand its network of community health workers to other countries; revenue generated for the franchisor came primarily from consulting fees and margins charged on the products sold to community health workers for resale to poor households, but this still left a significant funding gap to be filled by donors).

[32] *See* Deborah Burand & David W. Koch, *Microfranchising: A Business Approach to Fighting Poverty*, 30 FRANCHISE L.J. 24, 25 (2010) (noting that the question of what constitutes "affordable" business opportunities for the poor needs to be contextualized to the places where microfranchises are operating; as others have observed, average costs of acquiring a microfranchise can vary greatly).

[33] Franchisors in a microfranchise network often will aim to recruit franchisees that share certain characteristics – such as economic status or gender – and will create selection and training processes accordingly. For example, harken back to Martha Matilda Harper's franchise and the decision to recruit poor women as the first franchisees.

All of which is to say, when we use the term "social franchise" in this article, we draw on social sector franchising and microfranchising characteristics, but are not so constrained. We are thinking broader than social sector franchising and bigger than microfranchising.

2. Lockstep Franchise Networks

Another category of a social franchise network is the lockstep franchise network. The lockstep franchise network, in contrast to the trade-off franchise network, aims to generate both financial and social/environmental returns from its franchise activities. More specifically, in a lockstep franchise network, the generation of social/environmental returns are expected to lead to financial returns, hence these two types of returns should proceed in "lockstep." If successful, the more positive impacts the lockstep franchise network generates, the more financially successful the social franchise network as a whole will be. These financial returns may accrue both to the franchisees and the social franchisor, although perhaps not equally.

An example of a lockstep franchise network is Jibu. Jibu uses a franchise model to create and distribute safe drinking water to urban communities in Africa.[34] Each franchisee in the Jibu network pays Jibu a relatively small start-up fee, and once the franchisee reaches certain operational milestones, also pays Jibu a network fee.[35] Here, the health benefits of consuming clean water and franchise profits grow in lockstep. The more potable water sold and distributed by a Jibu franchisee, the greater the positive health impacts of clean water use to the communities served by Jibu and the more profits accrue to the Jibu franchisee, and eventually to Jibu as the social franchisor.[36]

At this point, a reader might be forgiven for wondering why we've spent so much time and verbiage in drawing lines, albeit blurry lines, among the various ways that franchising practices can be applied to doing good. The reasons for these distinctions have significant consequences, as is discussed in greater detail below. One consequence is that not every social enterprise will benefit from using a franchise model to scale. Another consequence is that, for those social enterprises that do employ a franchise model, the social franchise relationships created and contracts that memorialize these franchise relationships may need to differ to reflect this distinction between trade-off and lockstep franchises. As one might imagine, it is more challenging to align and maintain an alignment of the interests of the social franchisor and its franchisees in a trade-off franchise than in a lockstep franchise.

---

[34] *See* JIBU, *How We Do It* (2019), https://jibuco.com/how-we-do-it/.

[35] *See id.* Typically, the network fee payment obligation will be triggered by the earlier of (i) a specified time after launch of business, and (ii) production of a specified amount of potable water by the franchisee.

[36] *See id.*

III. WHY (AND WHY NOT) USE A FRANCHISE MODEL TO SCALE SOCIAL ENTERPRISES

Channel your inner Martha Matilda Harper and imagine you, too, are the ambitious CEO of a growing social enterprise. Your company has a proven track record of success, generating both financial returns and social returns. Perhaps it is time to scale—widen your geographic footprint, expand distribution channels, and reach new markets. So, what business models might you consider, and is your business ready to adopt the model you choose?

At one end of the spectrum, you could grow the firm by reinvesting its profits, raising capital from outside sources, hiring more employees, and eventually establishing additional branches or subsidiaries in new markets. At the other end of the spectrum, you could contract with independent third parties, let them hustle to find the requisite financial and human capital necessary to grow, and instead focus your attention on creating distributorships or licensing arrangements with these third parties. Or you could franchise.

A. Why Franchise

From a social enterprise's perspective, there are several reasons to opt to franchise. Many mirror the reasons that make franchising an attractive scaling approach in the commercial sector. Here are three key reasons to franchise.

First, franchising grows operations, brand, and impact quickly by leveraging the time, efforts, and, possibly, capital of its franchisees, without requiring the franchisor to hire significantly more employees. Related, franchising offers the franchisor the opportunity to grow while maintaining a relatively lean structure that avoids incurring significant overhead expenses and reduces its role in day-to-day management. Second, franchising can motivate management by giving franchisees ownership and, thus, a strong vested interest in the success of their franchise outlets. Highly motivated management can lead to better run operations, and a closer connection to local communities and target customers. For a social enterprise, staying connected to the operational frontline even while expanding is likely to be of particular interest.[37] Third, franchising can reduce risks for the franchisor, such as limiting liabilities that arise out the operations of its franchise outlets—for example, minimizing exposure to contingent financial liabilities or vicarious liabilities to franchisee employees. And, a franchise model may make it less costly to operate in markets with rigid employment laws that impose restrictive conditions on hiring and terminating employees.[38] Franchising

---

[37] *See* Ben Cook, *Social Franchising: How Do You Do It and What Are the Benefits?*, THE GUARDIAN (Nov. 6, 2012, 3:00 AM).

[38] This, of course, can be at odds with the social franchisor's broader mission goals. So, care needs to be taken to ensure that franchising practices are not undertaken to dodge employment laws nor give rise to the perception that such legal protections for employees are intentionally being evaded. Furthermore, as noted in the below comparison of franchise agreements' contractual terms, some social franchises require that franchisees engage in fair labor practices for their employees that exceed

also can reduce political and cultural risks that come when operating in new markets by allowing the franchisor to draw on the expertise and connections of its local franchisees.[39]

There are also good reasons to choose to become a social franchisee. In a commercial franchise, the franchisee gains the opportunity to own a business and enjoy the autonomy of operating that business, while still benefitting from the larger network—its resources, know-how, buying power, training, advertising, and more.[40] Presumably, in a social franchise, these benefits would accrue to a social franchisee as well. Additionally, a social franchise network offers the franchisee other intangible benefits of being identified with a socially motivated brand. This identification may confer status and enhance the franchisee's reputation in her community. Last but not least, a social franchise network also provides its franchisees with an opportunity to align their personal values and business goals, so that they can "walk the talk." If ownership of a social franchise outlet can lead to more committed managers, as has been observed in commercial franchises, then ownership of a social franchise outlet that reflects the franchisee's values may lead to an even deeper managerial commitment and loyalty to the brand.[41]

For franchisees located in emerging markets, particularly those living at the base of the economic pyramid with limited access to capital and few financial assets, the benefits of participating in a social franchise network are even more obvious. For them, acquiring a social franchise outlet can be a relatively low-cost way of starting a business.[42] Belonging to a social franchise network also can help ensure the success of that business. For example, in markets where access to information, expertise, and distribution networks may be limited, being part of a social franchise network can help the business succeed by providing the franchisee with technical assistance, mentorship, and consistent sources of inventory, to name a few of the benefits that franchise networks can confer on franchisees.[43]

---

the standards required by local law.

[39] *See* Zeidman, *supra* note 11, at 241-42.

[40] *See id.* at 242-43.

[41] See, for example, Wildflower Schools, which describes itself as an "ecosystem of decentralized Montessori micro-schools [operating in United States] that support children, teachers, and parents," and its 9 principles for deepening engagement of schools, homes and communities (available at https://wildflowerschools.org/).

[42] *See* David B. Guenther & David W. Koch, *International Microfranchising: The International Transactions Clinic's Experience*, MICH. BAR J. 34, 35 (2017). Note that this can take place outside of emerging markets too, such as in the United States. See Wildflower Schools, *supra* note 41.

[43] *See* Monica C. Dichon et al., *Microfranchise Emergence and Its Impact on Entrepreneurship*, 13 INT'L. ENTREPRENEURSHIP & MGMT. J. 553, 569 (2017); *see also* Guenther & Koch, *supra* note 42, at 35. While this makes intuitive sense and reflects the experience of many more commercially oriented franchise outlets, this is an area where further research would be useful to determine the actual success rates of social franchise outlets.

B. Why Not Franchise

There are also reasons social enterprises may decide *not* to use a franchise model to scale. The considerations that will inform that decision will turn on issues such as what to franchise, where to franchise, and when to franchise.

What to franchise? Some social enterprises may decide that the products they distribute may not be suitable for franchising because of the potentially dangerous consequences to consumers if franchisees engage in product tampering. Or they may avoid franchising social services to vulnerable populations, particularly where improper or inconsistent delivery of services could have serious negative impacts on intended beneficiaries.[44] As some have cautioned, franchising "may not be suitable for social enterprises that work with vulnerable people" where control over the actions of the franchisee is of paramount importance.[45] In both of these examples, the social enterprise may decide that to prevent such adverse consequences, it is better to opt for the more controlling role of an employer managing and supervising employees than the contractual relationship that governs the engagement of a franchisor with its franchisees.

Where to franchise? It is important to test the business model and related product or service offering in new markets before committing to franchising. Not only is it important to confirm that there is demand for the products or services to be distributed in the prospective market, but it also is important to make sure that the business model that worked in the original setting will translate to and work equally well in the prospective market.[46]

When to franchise? The proof of concept of the business model and product/service offering needs to be sufficiently established before scaling of any kind is appropriate for a social enterprise. But this is particularly an issue for franchising. As others have warned, "if a social concept is yet to be perfected, franchising will merely replicate its existing problems, which will ultimately result in failure of the entire franchise network."[47] Additionally, the stage of development or maturity of the social enterprise organization may suggest that the social enterprise is not yet "franchise-ready." For a social enterprise to assume the role of social franchisor, it needs to have sufficient organizational stability to handle swift expansion. It needs to be financially stable enough to support the needs of a larger organization and operationally stable enough that it can focus on establishing and monitoring its franchisees, undistracted from other operational challenges.[48] This can be a problem if the social enterprise's business model and

---

[44] *See* Asemota & Chahinem, *supra* note 6, at 2743 (setting out factors for a social enterprise to consider when assessing whether to replicate its operations through a franchise model).

[45] Cook, *supra* note 37 (quoting Ceri Jones, Social Enterprise UK's head of policy at the time of the interview).

[46] *See* Asemota & Chahine, *supra* note 6, at 2742.

[47] *Id.* (describing the case of Aspire, a social franchise that ultimately failed because its business model, which had limited market appeal, was unable to generate sufficient revenue to sustain the pace of growth).

[48] *See id.* at 2743.

operating systems either have not been fully systematized or are insufficiently standardized so as to be easily replicable. In short, if the social enterprise is still in a stage of experimentation and innovation, it may not yet know which elements of its business model are critically important for the success of its franchise outlets. This, in turn, will make it difficult to provide its franchisees with proven business opportunities.

A final obstacle to social franchising arises when the social enterprise is unable to devise sufficiently strong incentives and monitoring mechanisms to align—and to maintain alignment of—the interests of the social franchisor and its franchisees. These incentives need not be financial. Indeed, some social franchisors have created very effective nonfinancial incentives to reward desired conduct by their high-functioning franchisees by conferring extra status on them, providing them with extra training, or even loosening certain operational controls so that they can engage in more experimentation. Yet, if a social enterprise doesn't have the resources to monitor the conduct of franchisees, then these creative incentive systems may be worse than useless, particularly if they become vulnerable to manipulation by franchisees.

The need for incentives and related monitoring of franchisee behavior may be more challenging to achieve in a trade-off franchise than a lockstep franchise because of the lack of a positive correlation between social returns and financial returns. However, this could become an issue for a lockstep franchise as interests are fluid and can fall out of alignment, sometimes due to circumstances outside of either party's control. Imagine, for example, the adverse and costly impact that catastrophic weather events can wreak on a franchisee's ability to operate. Or consider the challenges of operating a service-oriented social franchise, like that of Harper's hair salons, during a pandemic. No incentive and monitoring system can ensure the continued productivity of a franchise outlet that is underwater due to a tsunami, reduced to rubble by a hurricane or tornado, or shut-down by government edict during a widespread health crisis like COVID-19. On the other hand, a social franchise agreement can be designed to help the social franchisor and its franchisee navigate challenges that arise from exogenous events outside of either party's control.

IV. HOW TO CONTRACT FOR SOCIAL FRANCHISES

The franchising that started first in the United States through the pioneering efforts of social entrepreneur Martha Matilda Harper and others now takes place worldwide. Although the franchisor/franchisee relationship is largely governed by contract, this contractual relationship may be regulated by the jurisdictions where the franchise operates. As franchising has moved to new jurisdictions, so too has there been a growth in the legal frameworks established to regulate franchising.

Philip Zeidman points out that the legal framework necessary for a thriving franchise sector arguably needs only three elements: (1) a sound system for protecting trademarks and other intellectual property, (2) recognition of the

sanctity of contract, and (3) a system for fairly resolving disputes that gives parties confidence that they can obtain effective recourse should something go wrong.[49] But that is not how franchise law has evolved globally.

Franchise regulation took root in the United States in the form of detailed disclosure laws and so-called "relationship" laws that override private contractual terms. Franchise-specific regulation in other jurisdictions has often, but not always, followed the legal and regulatory approach taken in the United States.[50] The result is that franchisors confront a variety of regulatory approaches that can differ from jurisdiction to jurisdiction. Additionally, in some jurisdictions, franchisors may struggle with a lack of express legal recognition of franchising. Moreover, there are many other laws beyond franchise-specific laws that shape the viability and structure of franchise business practices.[51]

For social franchises, the lack of a coherent global approach to regulating franchising is further muddled by the similar lack of legal frameworks for recognizing and, where appropriate, regulating social enterprises. This has led to the complaint that "[c]urrently there is an insufficient understanding of the regulatory frameworks and legal risks and benefits of various structures and contracting norms in social franchising."[52]

One way to address this insufficient understanding is to analyze the contractual relationships that are being forged in social franchising—both from a theoretical point of view and from a practical point of view.[53] The following discussion attempts to weave theory and practice together as we compare key contract terms of commercial franchise agreements with those of social franchise agreements and look for contracting norms. Yet, before engaging in this side-by-side comparative analysis, it is worth highlighting that this analysis has natural limitations, for all franchise agreements, whether commercial or social in orientation, operate within broader legal, cultural and socio-economic contexts that may have as much or more influence on the franchisor/franchisee relationship as the contract terms themselves.

A. Theory of Contracting for Social Franchises

Before examining the theoretical underpinnings of a social franchise agreement, it is important to ground ourselves in a common understanding of the

---

[49] *See* Zeidman, *supra* note 11, at 252.

[50] *See id.* at 251-52.

[51] Other laws and legal doctrines that can shape and possibly thwart a franchise relationship include, for example, intellectual property laws, especially trademark laws (shaping right of a franchisor to protect its trademarks and other intellectual property), antitrust and competition laws (limiting covenants against competition or other restraints of trade such as territorial/customer restrictions), employment laws/commercial agency doctrines (recharacterizing nature of franchisor's relationship with franchisees), tax considerations, currency restrictions, exchange controls, etc. *See id.* at 264-65.

[52] Crawford-Spencer & Cantatore, *supra* note 18, at 49.

[53] While outside the scope of this article, another area ripe for future research is how current regulation of franchises is responding to (or not) social franchises and to consider what regulatory approaches would encourage the development of a more robust social franchise sector.

main goals of any franchise agreement. More specifically, a franchise agreement is a contract between the franchisor and its franchisee by which they establish the rules that will govern their franchisor/franchisee relationship.

In a commercial franchise agreement, there are essentially four key areas where the parties must reach agreement. First, the franchisor agrees to the sorts of support it will provide to its franchisee.[54] The nature and scope of this support will vary according to the type of business activity, of course.[55] Second, the franchisee agrees to run the business according to the standards and in the manner stipulated by the franchisor.[56] Third, the franchisee commits to pay royalties, usually calculated as a percentage of sales, to the franchisor.[57] The franchisee also may commit to purchase inputs from the franchisor or from approved suppliers. Fourth, the parties agree to the grounds and process by which the franchise agreement can be terminated.[58]

As this shorthand summary of the scope of commercial franchise agreements illustrates, the franchise agreement must provide the franchisor with some control over the actions of its franchisee, yet, at the same time, ensure the franchisee's independence. As a result, franchise agreements must anticipate and address significant commitment problems—both of the franchisee and the franchisor—and the conflicts of interest that are likely to arise from these commitment problems.[59]

The essential conflict of interest that rests at the heart of a commercial franchising relationship is the tension between the franchisor's commitment to growing the top line and the franchisee's commitment to growing the bottom line. For example, the franchisor, in an effort to grow revenues and extract more value from its franchise network, may impose costs on its franchisees from time to time. These costs are in addition to the initial investments made by franchisees to acquire their franchise outlets. The franchisor may impose these costs directly by raising prices on goods or other inputs sold to franchisees or increasing royalties charged to franchisees. Or, an even more common point of friction in commercial franchising, the franchisor may impose these costs indirectly by requiring the franchisee to undertake costly renovations, implement new technology or product and service changes, or engage in advertising promotions.[60]

---

[54] *See* Rubin, *supra* note 17, at 224.

[55] For example, a location-based franchise such as a restaurant or fitness club may involve assistance with site selection, lease negotiation, and buildout. By contrast, for a mobile business, where franchisees perform services at customer locations, support may involve vehicle selection, customer scheduling, and route planning.

[56] *See* Rubin, *supra* note 17, at 224.

[57] *See id.*

[58] *See id.* These are not the only issues that a franchise agreement will address. For example, other matters typically include rights of the franchisee to sell its franchise, rights of heirs of the franchisee to inherit the franchise, and rights of the former franchisee to open a competing business in the event the franchise relationship is terminated.

[59] *See id* at 224-25.

[60] *See* Hadfield, *supra* note 12, at 949-51 (noting that the franchisee's investment in establishing the franchise (financial and/or time) is a sunk cost that it will not easily recover if the franchisor extracts value from the franchisee by imposing costs that are unlikely to generate more profits for the

No matter whether directly or indirectly imposed, these additional franchise costs will not be welcomed by franchisees that are attempting to reduce the operating costs of their respective franchise outlets in order to achieve or increase profitability. Moreover, most franchisees will not be keen to invest additional effort or incur additional expenses in operating their franchises unless such efforts or expenses can be expected to lead to more profits for their individual franchise outlet.

This "what's in it for me" franchisee dynamic can give rise to what Prof. Gillian Hadfield, in her article, *Problematic Relations: Franchising and the Law of Incomplete Contracts*, calls "franchise free-riding."[61] She observes that a franchisee will face a strong economic incentive to act in ways that are likely to increase the profitability of its own franchise outlet, but much less of an economic incentive to undertake efforts or expenses necessary to benefit the franchise network as a whole. Indeed, some franchisees even may free ride on the efforts of their fellow franchisees in this regard. For example, so long as most other franchisees in the network are maintaining the quality standards associated with the franchise's brand or trademark, a franchisee may engage in quality-shading behaviors so as to reduce the operating costs of its franchise outlet yet still enjoy the value of the franchise's brand or trademark.[62] Of course, "[i]f all franchisees, facing the same incentives, act this way, the value of this [franchise's] trademark will suffer dramatically."[63]

The franchisor's need to control the behavior of its franchisees to avoid quality-shading behaviors and related free-riding is a classic principal-agent problem. But, as Hadfield notes, this is not a problem unique to franchising. Just as a franchisor seeks to align the interests of a franchisee with its own interests, so too does a manager seek to align employees' interests with that of the employer company and, hence, to minimize incentives for employees to shirk in the execution of their duties. What is different in a franchisor/franchisee relationship, say from that of a manager/employee relationship, is that the control issue posed by franchising is that of overcoming economic incentives for franchisees to pursue cost-reduction strategies at the expense of maintaining or improving the overall value of the franchise's brand or trademark.[64]

Franchise agreements typically do not resolve this inherent conflict of interest between franchisors and their franchisees. Instead, the franchise agreement is a starting point or, as Hadfield has described it, "a bare outline, one which is then filled in by the ongoing balance—the beliefs, powers, and incentives that

---

franchisee).

[61] *Id.* at 949.

[62] *See id.* at 949-50.

[63] *Id.*

[64] *See id.* at 950.

comprise the [franchisor/franchisee] relationship."[65] This has led Hadfield to characterize franchise agreements as "incomplete contracts."[66]

Nobel laureate economist Oliver Hart and his co-author Sanford Grossman coined the term "incomplete contract" in 1986 to describe those contracts that operate where it is not feasible to describe all actions available to the contracting parties or all states of the world that would necessitate such action.[67] Every contract is necessarily incomplete, but some contracts are more incomplete than others. Indeed, parties often deliberately choose to contract incompletely with each other to reduce the transactional costs of trying to anticipate and negotiate *ex ante* every issue that could emerge during the life of the contractual relationship.

When choosing to contract incompletely, parties will focus their contractual deliberations on determining *how* decisions will be made in the future rather than attempt to resolve a host of possible issues before the fact. They typically do this by specifying in the contract who holds decision-making authority and the principles that will guide or circumscribe such decision-making. Franchise agreements often take this approach, too, as the below comparisons of contractual provisions demonstrate.

Since the first articulation of the theory of incomplete contracting, Hart and others have applied this theory to explain the behaviors that underpin a wide array of contractual relationships. Most recently, Hart joined with two co-authors to look at how parties to purchasing contracts respond to contracting in an uncertain world.

Conventional purchase agreements, according to Hart and his co-authors, are structured to "protect against the possibility that one party will abuse its power to extract benefits at the expense of the other."[68] This adversarial attitude, they argue, undermines the partnership-like relationships needed to navigate "complex strategic relationships where the parties are highly dependent on each other, future events can't be predicted, and flexibility and trust are required."[69] A far better approach to contracting in such situations, according to Hart and his co-authors, is to create a "formal relational contract."[70]

---

[65] *Id.* at 957.

[66] *Id.* at 928. Hadfield observes that parties choose to engage in incomplete contracts when they desire "flexible, but bounded, responses to uncertain future conditions . . . ." *Id.* Incomplete contracts also often exist among parties who are not strangers to each other and where "much of their interaction takes place 'off the contract,' mediated not by visible terms enforceable by a court, but by a particular balance of cooperation and coercion, communication and strategy." *Id.*

[67] *See* Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J. POL. ECON. 691, 716-18 (1986).

[68] David Frydlinger et al., *A New Approach to Contracts: How to Build Better Long-Term Strategic Partnerships*, HARV. BUS. REV. 116, 118 (2019).

[69] *Id.*

[70] *Id.* at 119. Hart and his co-authors are not the first to consider and articulate the case for why parties might choose to engage in relational contracts. *See, e.g.*, Chapin F. Cimino, *The Relational Economics of Commercial Contract*, 3 TEX. A&M L. REV. 81 (2015) Stewart Macaulay, *Non-Contractual Relations in Business*, 28 AM. SOC. REV. 55 (1963); Ian R. Macneil, *The Many Futures of Contract*, 47 S. CAL. L. REV. 691 (1974); Robert E. Scott, *The Case for Formalism in Relational Contract*, 94 NW. U.L. REV. 847 (2000) ("All contracts are relational, complex and subjective. But

While Hart and his co-authors focus on how formal relational contracts can be used to govern complicated outsourcing and purchasing relationships between large companies such as Dell and FedEx, they point out that this approach to contracting can be applied to strategic alliances, joint ventures, public-private partnerships, major construction projects, collective bargaining agreements, and, yes, even to *franchise agreements*.[71] So it should not be surprising to see that many of the key characteristics of a formal relational contract can be found in social franchise agreements too.

A contract is "formal" in the sense that it is not a handshake; rather, it is in writing and legally enforceable.[72] It is "relational" in the sense that it is designed to foster trust and collaboration between the contracting parties.[73] It does so by specifying a shared vision, establishing guiding principles, and creating robust governance structures to keep parties' expectations and interests aligned over the long term.[74]

If there is a secret sauce to creating a formal relational contract along the lines advocated by Hart and his co-authors, it likely can be found in how the negotiations and resulting contract terms deliberately reinforce the contracting parties' mutual self-interest. According to Hart and his co-authors, this approach to contracting results in a "what's in it for *we*" partnership mentality, rather than parties opting for a purely self-interested approach such as that taken by the free rider franchisee that Hadfield observed.[75]

Much of what Hart and his co-authors have to say about formal relational contracts resonates when applied to social franchising, for it is these relational characteristics that differentiate social franchise agreements from their cousin commercial franchise agreements.[76] But this is largely a difference of degree, with social franchise agreements embracing, often more fully than do commercial franchise agreements, the articulation of mutual goals, guiding principles for expected behaviors, and the establishment of governance structures that aim to maintain alignment of social franchisor and franchisee interests. This will become more fully evident in the below contractual analysis.

B. Comparison of Key Contract Terms Used in Commercial and Social Franchises

Those who write about social franchising in academia often highlight the importance of franchise agreements to framing the relationship between franchisor

---

contract law, whether we like it or not, is none of those things.").

[71] *See* Frydlinger et al., *supra* note 68, at 119.

[72] *See id. But see* Ethan Lieb, *Contracts and Friendships*, 59 EMORY L.J. 649, 654, 715 (2010) (arguing that "formalism does not make sense in relational contracts" because social norms are likely to play a larger role in controlling parties' conduct than threat of legal sanctions).

[73] *See* Frydlinger et al., *supra* note 68, at 121.

[74] *See id.* at 121.

[75] *Id.* at 121.

[76] Hadfield has likened even commercial franchise relationships to a marriage of sorts. *See* Hadfield, *supra* note 12, at 964.

and franchisee, yet rarely provide more than a glimpse of actual contract terms.[77] Existing practitioner-oriented resources for potential social franchisors also often provide only general guidance.[78] What is missing from both of these sources is a detailed discussion of the contractual provisions recommended for or found in a social franchise agreement.

The authors' experience in working with social franchise networks suggests that franchise agreements for social franchises are often created *ad hoc*, then modified through trial and error, undergoing adjustments when the social franchisor concludes that the terms initially chosen do not align with its relationships and/or social and environmental objectives. In some cases, the perceived mismatch has been that terms borrowed from commercial franchising do not fit with organizational values or are ineffective for the organization's model.[79] Galen Welsch, the co-founder of the Jibu franchise network, put it this way: "We have had to change a few things over the years to adapt to our needs and my only wish is that we would have known them when we started . . . [t]he biggest things would be to build a less complicated franchisee fee structure, a more gradual ownership structure and a different franchisee selection process."[80]

This article aims to fill the gap by comparing key terms typical of commercial franchise agreements with terms drawn from social franchise agreements. One of our goals in writing this article is to better equip social enterprises to select contract terms that will help align social franchisor and franchisee commitment to the social mission. By understanding differences and choices in contract language, a social enterprise may be able to avoid mistakes and detours that might slow or imperil its social program.[81]

We compare below examples of the following clauses: (1) background/recitals, (2) contract duration, (3) renewal, (4) franchisor support, (5) ongoing fees, (6) brand standards and enforcement, (7) performance monitoring and reporting, (8) dispute resolution, and (9) employees and other stakeholders. The specific clauses compared below are taken from a variety of commercial franchise agreements drafted by one author in his private law practice and social franchise agreements that were either drafted or revised by University of Michigan and NYU law students under the supervision of the authors.[82] Names and other

---

[77] We noted this in 2010, and it remains true a decade later. *See* Burand & Koch, *supra* note 32, at 28; *see also* Crawford-Spencer & Cantatore, *supra* note 18, at 49 (analysis of contractual relationships of commercial franchising has not been applied to social franchising).

[78] UNLTD, *Legal Help Guides*, https://www.unltd.org.uk/our-support/learning-area/legal-help-guides (last visited Dec. 31, 2019). UnLtd offers legal help guides that provide an overview of various issue areas (e.g. legal structure, IP, employment, property, confidentiality, and privacy) and provides a template "Supply of Services Agreement," but not a franchise agreement.

[79] *See generally* Giudici et al., *supra* note 9 (recounting multiple adaptations of the franchise agreement between Impact Hub and its franchisees).

[80] Katie Murray, *Jibu: Why the Franchising Model Worked for My Business*, 1851 FRANCHISOR (Mar. 28, 2018, 2:00 PM), https://1851franchise.com/franchisor+spotlight.

[81] *See id.*

[82] The authors' exposure to social franchise agreement terms comes from practical experience – namely, from working with social enterprises in the International Transactions Clinics at the University of Michigan Law School and the NYU School of Law. Clinic clients usually have been

identifying information of the franchisors have been removed, and in some cases the original clause has been edited for presentation purposes.

Example 1: Background/Recitals. The first example compares the recitals clauses of a commercial franchise agreement with those of a social franchise agreement. Recitals clauses are routinely included in franchise agreements. The recitals provide context for the transaction and introduce key terms that will be used in the body of the contract.

In the sample commercial franchise recitals, the focus is to establish the franchisor's ownership of the intellectual property that will be licensed to the franchisee. The recitals proclaim in detail the trademark and know-how elements of the franchise, with the clear intention of retaining their benefits for the franchisor (and a corollary benefit of excluding the franchisee from any rights outside of the defined elements). The recitals are therefore franchisor-focused, with barely a nod to the other party—the franchisee—to the transaction.

In the sample social franchise recitals, the clauses similarly establish the social franchisor's intellectual property ownership. However, the recital clauses also clearly establish the social context of this franchise relationship by laying the foundation and describing a shared vision for this relationship.

More specifically, in the sample social franchise recitals, Recital A states the franchisor's social mission in clear, simple terms; Recital D affirms that the purpose of the franchise agreement is to expand that mission; and Recital E verifies that the franchisee shares the stated mission. Recital E also verifies that the franchisee understands the connection between advancing this mission and complying with the social franchisor's standards and, thereby, enhancing the overall reputation of the social franchise network.[83]

Taken together, these recitals found in a social franchise agreement depart strikingly from the commercial sample. The mutual statement of social intent provides a lens that will color the view of any reader who is called upon to assess the parties' respective rights and obligations in the franchise agreement. Readers may include not just the parties but also government authorities, social impact investors, and judges or other decision-makers in a dispute. More importantly, these recitals (and the conversations between the contracting parties that led to their memorialization in the social franchise agreement) establish the parties' shared mutual interest in participating in this social franchise relationship.

---

working with a contract of their own invention before arriving at the clinic. Some contracts were created internally by a non-lawyer, some were borrowed from another organization, and one or two were drafted by a local lawyer without experience in franchising. Clients have sought Clinic help because they were dissatisfied with their contracts for some reason, or because they were simply unsure whether their contract was right for their needs.

[83] One can imagine circumstances where the language found in Recital E might give a franchisee pause. This is most likely to take place in a trade-off franchise network where the franchisee is primarily interested in the financial returns, not social returns, to be generated by its franchise outlet. Yet, one might argue that it is precisely in such circumstances that a recital like that found in Recital E has the most value, as it makes express and mutual the franchisor and franchisee's commitment to the social mission and conduct that is consistent with that mission.

Commercial franchise

A. ABC Company is in the business of franchising and licensing others to operate ABC foodservice outlets in various formats ("Restaurants").
B. The Restaurants offer hot and cold sandwiches and other food and beverage items for on-premises consumption, carry-out, catering, and/or delivery using a distinctive operating system developed by ABC (the "System").
C. The distinctive elements of the System include, but are not limited to: our menu items, recipes, and product mix; the exterior and interior design, décor, color scheme, fixtures, and furnishings of the Restaurants; our Proprietary Products (as defined below); our standards and specifications for ingredients, food preparation, equipment, supplies, and restaurant operations; our advertising and promotional programs and marketing techniques; our customer service standards; and the accumulated experience reflected in our operations manual, training program, and instructional materials. Some elements of the System may vary based on the size and type of Restaurant.
D. We identify the Restaurants by means of the ABC mark and certain other trademarks, service marks, logos, and commercial symbols (collectively, the "Marks").
E. You wish to obtain the right to operate a Restaurant at the Approved Location, as defined below.

Social franchise

A. XYZ is a not-for-profit organization whose mission is to provide hearing aids to underserved communities in a fast, affordable, and sustainable manner.
B. XYZ has developed a technology platform, supply chain, training, operating procedures, inventory control procedures, know-how, and specifications (collectively, the "System") to deliver affordable hearing aids and services through Audio Technicians.
C. XYZ has developed and owns the "XYZ" name and certain other trademarks, service marks, trade names, signs, logos, and other indicia of origin that identify the XYZ System, products and services (collectively, the "Marks"). XYZ may designate other trade names, service marks, and trademarks as Marks.
D. XYZ licenses the Marks and the System to organizations approved by XYZ to expand the mission of the XYZ program.
E. Affiliate shares XYZ's mission and understands the importance of upholding and enhancing the reputation of the XYZ program and operating the Center (as defined in Section [ ]) strictly in accordance with the XYZ System and the terms of this Agreement.

Example 2: Contract Duration. The next example compares the duration and renewal terms of the commercial and social franchise agreements. Commercial franchise agreements typically are long-term agreements, with two primary factors influencing the length of the term. One factor is the level of investment required of the franchisee. To induce that investment, the franchisor must offer a term that is long enough to give the franchisee a reasonable chance to recoup its investment and earn a return—logically, then, the higher the required investment, the longer

the term. The second factor is the length of contract offered by competing franchise opportunities, particularly those in the same line of business as the franchisor. In the sample clause below from a quick service restaurant concept, the initial term is 10 years, probably the most common choice in the last decade of commercial franchising.

The factors driving length of term in the commercial context are not likely to be present in the social franchise context. Social franchises frequently, though not always, require less of a financial investment by the franchisee than commercial ones.[84] And prospective franchisees are less likely to be shopping around for alternative opportunities. More likely, they have focused on the particular opportunity because they have a commitment to the social franchisor's specific social mission. On both counts, market pressure for a long contract term is missing.

There might also be other factors influencing a shorter contract term for social franchises, however. For example, if the social franchisor's program is backed by time-limited funding, the social franchisor may be reluctant to commit to a contract term with its franchisees that exceeds the duration of the funding. This is likely to arise, for example, in trade-off franchises where the franchise network has not been able (possibly by choice) to reach financial sustainability and so is heavily reliant on donor funding. In addition, social franchisors may perceive greater risk in a longer-term relationship because of higher reputational stakes where the social franchise delivers sensitive personal, family or household services to vulnerable populations. These factors point toward a significantly shorter term of years or, as in the sample below, an indefinite term that can be ended by the social franchisor at any time on relatively short notice.

Commercial franchise	**Social franchise**
This Agreement will expire ten (10) years from the Opening Deadline or from the actual opening date of the Restaurant, whichever is earlier.	This Agreement will remain in effect until terminated under Section [ ] *[termination without cause on 90 days' notice]* or Section [ ] *[termination for cause]* below.

[84] In part, the investment is lower because social franchisors are less likely to demand a large, up-front fee from the franchisee. And even if the required start-up capital is similar to that of a commercial franchise, the social franchisee might not be expected to bear the entire capital cost. Jibu, for example, provides water filtration equipment to its franchisees on loan. JIBU, *Learn More About Jibu*, https://jibuco.com/the-jibu-solution-2/ (last visited Dec. 31, 2019). In addition, some social franchises use a "fractional franchise" model, in which the franchisee adds on the social program to a pre-existing business. Marie Stopes International, for example, uses a fractional franchise model and, therefore, looks to already operating healthcare providers when selecting franchisees. MARIE STOPES INTERNATIONAL, https://mariestopes.org (last visited Dec. 31, 2019). Required investment is less for starting up a "fractional" franchise because the franchisee can leverage its existing facility, staff, and other assets to start up and operate the business.

Example 3: Renewal. Commercial/social differences similarly manifest themselves in clauses providing for renewal of the franchise rights at the end of the initial term. In commercial franchise agreements, renewal typically is at the option of the franchisee, subject to certain conditions (see the sample below, which has been abbreviated for presentation). One of the typical conditions is signing an updated form of franchise agreement, because much may have changed in the world during the lengthy initial term (e.g., technology, commercial norms, legal standards, marketing approaches, and the franchisor's market position). If the franchisee satisfies the stated renewal conditions, the franchisor cannot refuse renewal without breaching the contract. This approach, like the length of the initial contract term, is driven by economics—franchisees are reluctant to invest at the outset without assurance of the opportunity to renew and some control over its implementation.

In social franchise agreements, the social franchisor tends to have dual objectives for renewal. One is to preserve flexibility to end the relationship if the franchisee is not contributing to or, worse still, is thwarting or undermining the social franchise's mission. The other is to make renewal as simple as possible if the relationship is going well. A discussion about renewal, therefore, is in essence a determination about whether franchisor and franchisee interests are still aligned, and an exploration of what needs to happen for that alignment to be maintained.

In the social franchise clause below, both parties have equal rights to call off the relationship at the end of the initial term. There is an annual right to assess whether to continue the relationship, so the detailed conditions set out in the commercial clause are not necessary. And because the initial contract term was short, there is less likelihood that the contract terms have gotten out of date, making it possible to simplify renewal by rolling over the existing contract terms.[85]

[85] Of course, after multiple renewals, the original contract terms may well become stale, but both parties can manage that risk by exercising the right to give notice of non-renewal and then entering into discussions of a new contract. Similarly, if the franchise agreement has an indefinite term, each party may have the right to terminate on reasonable notice and could leverage that right to initiate discussions to modify any contract terms that have become stale.

Commercial franchise	**Social franchise**
You will have the option to continue the franchise relationship with us for one additional term of ten (10) years, unless before the end of the Agreement Term: (a) we have announced a decision to stop franchising the ABC concept; or (b) we decide to withdraw the ABC concept from the metropolitan area that includes the Approved Location. If clause (a) or (b) applies, we will waive the post-term restriction on competition in Section [ ]. We may require you to satisfy any or all of the following requirements as a condition of renewing the franchise relationship with us: • written notice of your desire to renew . . . • not in default of this Agreement . . . • demonstrate right to remain in possession of the Approved Location for the full new 10-year term . . . • good record of customer service and compliance with Brand Standards . . . • sign the standard form of franchise agreement that we are then offering to new franchisees . . . the terms of which may be substantially different from the terms of this Agreement . . . • pay us a renewal fee . . . • sign a general release of claims against us . . .	On the third anniversary and each subsequent anniversary of the Agreement Date, this Agreement will automatically renew for another year unless either you or Franchisor has given notice of non-renewal at least two (2) months before the anniversary date.

Example 4: Franchisor Support. Differences between commercial and social franchise agreements also surface in the clauses describing the support to be provided by the franchisor to the franchisee, particularly the ongoing support to be provided after the franchise opens. In the commercial example below, the franchisor's promised support is fairly non-specific (e.g., "reasonable advice and consultation" in clause A; obligation to "inform" the franchisee in clause D). In some places the support is almost discretionary (e.g., local store marketing advice "that [the Franchisor] deems helpful" in clause C), and in others it comes at the franchisee's cost (e.g., the franchisor will provide "necessary" training materials "at Franchisee's expense," in clause D). The franchisor even reserves the right to delegate all of its support functions without the franchisee's consent (clause E). Clauses such as these are not unusual in commercial franchise agreements, and their soft edges can make it difficult for franchisees to demonstrate a breach when they believe committed support from the franchisor is lacking.

The social franchise agreement sample, on the whole, is more specific about the support the social franchisor will provide. While clause D reserves discretion as to "time, place, manner and amount" of support, the clause identifies in some detail the subject areas of assistance. Some of the support is for the basics of running a business, reflecting the greater likelihood, compared to the commercial sector, that the social franchisee will have little to no prior business experience or the social franchisee's prior business experience will not be relevant to the needs of the social franchise. And clause B promises assistance with government requirements, which most commercial franchisors are reluctant to provide. These specifications are not the result of negotiations or special demands by a social franchisee. Rather, they reflect the social franchisor's conception of the support it must offer to retain franchisees in the relevant community who have committed to the mission of the social franchise. Nowhere is this more evident than in the language promising ongoing support for "impact effectiveness."

Caution against overstating the commercial/social differences here is appropriate, however. The sample commercial and social franchise clauses are drawn from different types of businesses. Moreover, franchisor obligations often are scattered throughout the franchise agreement, so the specific clauses chosen may not fairly represent the commercial or social franchisor's support obligations as a whole. Still, this example illustrates a difference that is consistent with the authors' broader experience: namely, that in social franchise agreements, franchisor support obligations tend to be more concrete and reach beyond the four walls of the franchised business.

Commercial franchise

A. Company shall provide reasonable advice and consultation to Franchisee from time to time in connection with the operation of the Franchised Restaurant.
B. Company shall regularly develop and execute marketing programs and activities relating to [brand] restaurants and direct, prepare and/or place advertising, promotions and/or communications to build the brand. The marketing programs and activities may include [list follows]
C. Company shall provide advice on merchandising and local store marketing (including local coupon programs) that it deems helpful to Franchisee.
D. Company shall, during the term of this agreement, inform Franchisee of any new products, developments, techniques and improvements to the System. Company shall provide necessary training materials for the training of the Franchisee's employees, at Franchisee's expense.
E. Company may delegate the performance of any or all of its obligations under this Agreement to our designees, which may include our affiliates, agents or independent contractors.

Social franchise

The Franchisor agrees to:
A. Sell to the Franchisee supplies as needed for the Franchise Business.
B. Obtain the initial government qualify standard certifications required in the Territory and extend the certification to the Franchisee while this Agreement is in effect.
C. Provide ongoing support in a time, place, manner, and amount as determined by the Franchisor, including:
    a. Training on equipment operations and maintenance, business management and marketing, [customer health] education, and impact effectiveness;
    b. Guidance on administrative, bookkeeping, inventory control, and general operating and management procedures, including providing the Franchisee with accounting and financial templates and/or software and instruction in using them;
    c. Design guidelines and templates for marketing and advertising materials for Franchisee to use with the Territory; and
    d. Replacement of any malfunctioning leased equipment, at no cost to Franchisee if the malfunction is not due to user error, negligence, or abuse, as determined by the Franchisor
D. Provide regional and extraterritorial marketing and advertising as the Franchisor determines necessary.

Example 5: Ongoing Fees. Commercial business-format franchises make their money from an ongoing royalty fee. The fee is nearly always structured as a percentage of the franchisee's sales; on rare occasions, it is a recurring flat fee or other structure. The typical clause is not complicated, as the sample below demonstrates.

The ongoing fee in a social franchise agreement is not as single-mindedly devoted to generating financial returns for the social franchisor. Indeed, as discussed in Section II.C.1, some social franchises are willing to trade-off financial returns for social and/or environmental returns. The focus instead is on sustainability of the franchise system for the benefit of the mission and those it serves. The royalty clause may be written to emphasize the direct link between the franchisee's financial contribution and the sustainability of the mission. To provide franchisees with assurance of alignment of objectives, the clause might even commit the social franchisor to use a minimum proportion of the franchisee's payments for the social mission. And the fee structure itself is less likely to come across as a self-interested "take mine off the top" by the social franchisor and more likely to express a sharing of risks and burdens. Two samples appear below—the first using a fee based on product cost rather than sales, and the second using an express cost-sharing arrangement.

Commercial franchise	**Social franchise**
You must pay us an ongoing royalty fee of [] percent ([_]%) of the Net Revenue of the Restaurant.	Sample One: To help support the costs of the XYZ program and expand the mission of XYZ, Affiliate agrees to pay an ongoing royalty fee of [__] for each [medical device] supplied by XYZ to Affiliate. Royalty fees will be added to the cost of each [medical device] supplied by XYZ to Affiliate and included with the amount billed by XYZ in accordance with the Terms and Conditions under Section [ ]. Sample Two: Franchisee agrees to reimburse XYZ for one-half of XYZ's reasonable expenses for the following activities: a. Expenses incurred by XYZ for visits to the Territory (including reasonable travel and lodging expenses of XYZ representatives); b. Costs incurred to third parties for background checks of Franchisee and its personnel; and c. Reasonable attorneys' fees incurred by XYZ for advice from counsel in the Territory regarding the franchise opportunity, protection of intellectual property, and related agreements.

Example 6: Brand standards and enforcement. Brand standards are vital to both commercial franchises and social franchises. The term "brand standards" refers to all of the details of operation of the franchise that are either directly customer-facing or inevitably affect the customer experience. They are the elements that customers identify with the franchise brand—the appearance of the facility, mix of products and services, quality of products and services, marketing, service model, etc.

The sample clauses below set out the franchisee's basic obligation to follow brand standards. The basic obligation is the same in each sample, but there are notable differences between the approach taken by a commercial franchise agreement and that of a social franchise agreement.

The commercial franchise sample stakes out the position that the brand standards are an extension of the franchisee's contractual obligations, and thus a failure to follow brand standards is a breach of the franchise agreement. The contract gives the franchisee little leeway to avoid a default. While notice of the default most likely would trigger an opportunity to cure and thereby avoid

termination, the approach taken in the commercial contract is legalistic and, frankly, threatening.

In the social franchise sample, the brand standards are re-named "customer experience requirements," perhaps a more intuitive term to the social franchise operator. Moreover, the clause signals a major difference in implementation when it promises that the social franchisor "will work with" the franchisee on correcting deficiencies. In keeping with the collaborative approach to achieving social goals, the social franchise sample offers an educational response to deficiencies rather than a legalistic one. In practice, an enlightened commercial franchisor will do the same, but the typical commercial franchise agreement avoids language that would appear to water down the franchisor's enforcement rights.

The social franchise sample also pairs the customer experience requirements with an obligation to comply with the social franchisor's Code of Ethics. Though not reproduced here, this social franchisor's Code of Ethics contains a set of statements related to the overall objective of "treating all people with respect – fostering supportive relationships while conducting business with professionalism and integrity."[86] The aspirational statements to which the social franchisee subscribes include "compet[ing] fairly among the franchise community", "treat[ing] my employees, contractors, vendors and customers fairly and ethically," and " acknowledg[ing] disputes may arise among . . . stakeholders from time to time, and . . . commit[ting] to promptly finding an amicable solution for the sake of my business, my peers, and [the franchisor]."[87] Such subjective and broad commitments are not likely to turn up in the brand standards of a commercial franchisor.

[86] CODE OF ETHICS (on file with authors).
[87] *Id.*

Commercial franchise

In order to protect the reputation and goodwill of the ABC brand and to maintain high standards of operation under the System, you agree to comply strictly with all of our mandatory Brand Standards. You acknowledge that the Brand Standards may relate to any aspect of the appearance, operation, and marketing of the Restaurant. Any material failure to comply with the mandatory Brand Standards or to pass our periodic quality control inspections will constitute a material breach of this Agreement. However, you acknowledge that we have the right to vary our standards and specifications, in our reasonable judgment, to accommodate the individual circumstances of different franchisees.

You must comply with our quality assurance program, at your own expense. The program may include, among other things, customer satisfaction surveys, mystery shopper reports, employee satisfaction and perception surveys, health and safety reviews, and observation of your operations. We may allocate among Restaurants the cost of the services of any independent third parties that we designate to conduct these programs. If you do not achieve the minimum score that we prescribe for a specific quality assurance category, we may require you and/or your employees to complete additional training at a location we designate, at your expense. If you do not achieve the prescribed minimum score on two consecutive assessments or on three or more assessments in any five (5) year period, we will have the right to terminate this Agreement under Section [ ].

Social franchise

Below is a detailed list of XYZ's Customer Experience Requirements (CERs). A dedication to customer service is a core part of XYZ's values, and we take these requirements seriously. Should a Franchisee fail to meet these requirements, XYZ will work with the Franchisee to correct the failure. However, consistent failure to meet the CERs will trigger application of the Enforcement Policy as published by XYZ to the franchise network, and the potential termination of the Franchise.
[followed by list]

The Franchisee must [also] comply with XYZ's Code of Ethics . . . in operating the Franchise Business.

Example 7: Performance monitoring and reporting. There is a clear distinction between commercial franchise agreements and social franchise agreements in terms of monitoring franchisee performance. In the commercial contract, monitoring and reporting provisions are designed to protect the franchisor's financial interests. They focus heavily on financial reporting to verify that the franchisor has been paid properly and that franchisees will remain in

business and continue contributing to the income stream. Occasionally the metrics include revenue targets, minimum royalties, requirements to open additional locations, or other quotas, but these too are for the purpose of enhancing the franchisor's economic return. So too are non-financial data, such as customer satisfaction scores, service time, complaint rates, etc., that are collected to improve operations and promote benchmarking, again with the ultimate aim of increasing the income stream to the franchisor.

Social franchise agreements, not surprisingly, focus on the franchisee's execution against the social franchisor's mission goals. Accordingly, social franchise agreements include explicit requirements for franchisees to collect and share data on customer outcomes (or to permit the social franchisor to access the data directly). Of course, social franchisors must monitor whether franchisees are financially viable and meeting their obligations, but gathering data on the social mission may take priority.[88] The knowledge by both parties that the franchisee's social impact will be measured is a powerful force in keeping them aligned on the mission.[89] And on a system-wide level, social impact data are needed by the social franchisor to attract future socially-oriented franchisees, to inform decisions on where to expand the social program,[90] and perhaps to fulfill commitments to grantors and social impact investors.

The social franchise clause below establishes performance indicators that the franchisee is expected to meet. However, the specific indicators, as well as the acceptable ranges of performance, are left to an appendix to the contract. This approach allows flexibility for local customization as well as for possible future changes in the performance metrics and the assessment methodology.[91] Like the brand standards example, the clause leaves room for collaboration and correction before the franchisee suffers adverse consequences, while still giving the social franchisor a range of options to protect intended social beneficiaries—and the reputation of the program—from the franchisee's deficient performance.

---

[88] Asemota & Chahine, *supra* note 6, at 2751 ("social franchising takes evaluation one step further to assess the impact of the venture on the desired social outcome. If the venture aims to benefit a certain target population or ecosystem, then in addition to tracking the financial and management performance indicators, it is by definition required to track the intended social and/or environmental benefits.").

[89] *Id.* at 2750 ("an evaluation system will also help align activities at the franchisee site with the interest of the franchisor by preventing activities at franchisee site(s) that could undermine the efforts of the franchisor at developing the brand and franchise network.").

[90] *Id.* at 2751.

[91] *See id.* at 2751 (where "services are flexible and may differ from franchisee to franchisee due to an emphasis on locally relevant content, in local languages, and product development based on customer feedback . . . evaluating the social impact requires a locally tailored approach.").

Commercial franchise

Financial Statements. Within fifteen (15) days after the end of each calendar month, you must submit a statement of financial condition (a balance sheet) as of the end of the calendar month and a statement of income and expenses for the month and for the fiscal year-to-date. The financial statements must be certified as correct and complete by the Key Person. If you have received a written notice of default from us for non-payment of any amounts due, or if an examination or audit under Section [ ] reveals that the Net Revenue reported for any period of three consecutive months was more than [_]% below the actual Net Revenue for the period, we have the right to require that subsequent financial statements be prepared and/or audited by an independent certified public accountant.

Right to Examine or Audit. We have the right, at any time, to examine and copy, at our expense, the books, records, accounts, and tax returns of the Franchised Business and the personal tax returns of the Owners. We also have the right, at any time, to have an independent audit made of the books and records of the Franchised Business. You must cooperate with the persons making the examination or audit on our behalf. If you or we discover at any time, by means of an audit or otherwise, that there has been an underpayment of royalty fees or other amounts due, you must promptly pay the amount due, together with applicable late fees and interest. Your payment and our acceptance of the overdue amounts will not constitute a waiver of or prejudice our right to exercise any other remedy in this Agreement, including termination.

Brand Standards Assessment. You must comply with our Brand Standards monitoring program, at your own expense. The program may include, among other things, customer satisfaction surveys, mystery shopper reports, employee satisfaction and perception surveys, health

Social franchise

Reporting Requirements. Affiliate must send to XYZ the financial and operational reports specified in the Policy Manual from time to time. All reports generated by Affiliate will constitute "Confidential Information" and be the property of XYZ for purposes of this Agreement.

Performance Indicators. Affiliate will use its best efforts to satisfy the performance indicators set forth in the Appendix. If Affiliate's performance falls below the acceptable ranges set forth in the Appendix, the Affiliate must immediately notify XYZ in writing and promptly take any corrective action requested by XYZ. If the Affiliate fails or refuses to initiate the requested corrective action within thirty (30) days after receipt of the request from XYZ or fails or refuses to continue thereafter a bona fide program to complete the corrective action, XYZ will have the right to stop supplying XYZ Products, to reduce the size of the Territory, to deactivate the Technology Platform and demand the return of hardware and software provided by XYZ, or to take other measures as XYZ may deem necessary in its sole judgment with reasonable consideration of the Affiliate's performance metrics. Failure to comply with the corrective action requested by XYZ within 6 months after the date of the request will be grounds for termination of this Agreement by XYZ.

> and safety reviews, and third-party observation of your operations. If you do not achieve the minimum score that we prescribe for a specific Brand Standards category, we may require you and/or your employees to complete additional training at a location we designate, at your expense. If you do not achieve the prescribed minimum score on two consecutive assessments or on three or more assessments in any five (5) year period, we will have the right to terminate this Agreement under Section [ ].

Example 8: Dispute resolution. Dispute resolution provisions in commercial franchise agreements typically favor the drafter—i.e., the franchisor. To promote consistency of interpretation—and perhaps to discourage legal challenges by franchisees—the contract usually chooses the law and courts of the franchisor's jurisdiction. Alternative dispute resolution mechanisms (such as mandatory mediation in the sample below) primarily are designed to manage costs for the franchisor rather than to offer an olive branch to the franchisee. The dispute resolution provisions may include an array of other bells and whistles for the franchisor's benefit, including a time limit on filing claims, a class action waiver, an attorneys' fee provision, and liquidated damages.

Under U.S. laws, commercial franchisors have an obligation to disclose certain litigation to prospective franchisees; accordingly, franchisors worry that disputes and legal proceedings will deter investment by new franchisees. Commercial franchisors do not, however, generally worry about how litigation with franchisees will affect customers of the franchises.

The calculus is different for social franchisors. To give one example, for social franchises that are delivering much needed services, continuation of services to beneficiaries of the social mission is likely to be paramount. Furthermore, if the social franchisor earns a reputation for engaging in hard-ball litigation tactics against franchisees, that reputation could taint the social mission in the very communities the social franchise is intended to serve. Although social franchisors do get into legal battles with franchisees and former franchisees from time to time,[92] their dispute resolution provisions are structured to enhance the opportunity to preserve franchise relationships. Social franchise agreements typically omit provisions that come across as heavy-handed and one-sided and use dispute resolution provisions that are more likely to be local to the franchisee, to be less formal, and to draw on the collective sense of social mission among peer

[92] While some may argue about whether the NAACP falls within the definition of social franchise, here is an example of a dispute between a socially-oriented franchisor and franchisee. *See* NAACP, Nat'l Office v. NAACP, Cincinnati Branch, No. 1:15-cv-00433, 2015 WL 4164696, at *3 (S.D. Ohio July 9, 2015).

franchisees, possibly even using peer pressure to reinforce brand standards.[93] In the sample, use of a council of franchisees (called in the sample a "dealer council"), turns Hadfield's concern about free riding franchisees on its head. Rather than turning a blind eye to noncompliant franchisees that are free-riding on their good conduct, fellow franchisees instead are enlisted to help ensure compliance with brand standards across the network.[94]

[93] *See generally* Eric A. Posner, *The Regulation of Groups: The Influence of Legal and Nonlegal Sanctions on Collective Action*, 63 U. CHI. L. REV. 133, 155-157 (1996) (When members of a solidary group contract, norms, not legal sanctions, generally resolve disputes. These norms allocate risks, specify means of resolution, and prohibit bad faith and opportunism. Desirability of judicial intervention in a dispute will turn on (1) efficiency of group detection and sanctioning mechanism and (2) value of opportunism. Judicial intervention is more desirable and likely where efficiency of group detection and sanctioning declines and value of opportunism rises); Scott, *supra* note 70, at 852 (parties to relational contracts learn to behave under two sets of rules – strict rules for legal enforcement and more flexible rules for social enforcement). *See also* Eric A. Posner, *A Theory of Contract Law Under Conditions of Radical Judicial Error*, 94 NW. U.L. REV. 749 (2000) (Courts are radically incompetent when enforcing relational contracts because courts cannot accurately discern parties' behavioral intentions. Yet, under certain circumstances, radically incompetent courts can deter high-value opportunism that ordinary nonlegal sanctions cannot deter.).

[94] In this regard, franchise networks that make use of franchisee councils for enforcement of brand standards resemble the village banking models used by many early microfinance institutions, whereby a group of borrowers co-guaranteed the financial performance (repayment obligations) of fellow members.

Commercial franchise	Social franchise
Governing law. This Agreement and the relationship between ABC and Franchisee and the Owners is governed by the laws of the [state in which ABC has its headquarters]. Submission to mediation. Except as provided in Section [ ], before filing litigation, any dispute between us and you and/or the Owners must be submitted to non-binding mediation administered by a neutral mediation service with experience in franchise disputes. The mediation will take place in the city where ABC's principal offices are located at the time the demand for mediation is filed. Venue for litigation. Franchisee and the Owners must file any lawsuit against us only in the federal or state court where our principal office is located at the time the suit is filed. We may file a lawsuit against Franchisee or the Owners in the federal or state court where our principal office is located or where the Restaurant is located at the time the suit is filed. The parties waive all objections to personal jurisdiction and venue for purposes of carrying out this provision. Provisional or declaratory relief. Nothing in this Agreement prohibits either party's right to seek a restraining order, preliminary injunction, or declaratory relief in court under the applicable court rules.	If any dispute arises between you and XYZ regarding the performance of your obligations as an XYZ dealer, you agree to participate in good faith in the following process before initiating any formal legal proceedings: (i) A mandatory meeting with a member of the XYZ management team at your Shop or another location designated by XYZ, at the conclusion of which you and XYZ will adopt an action plan that you must follow to cure the breach; (ii) If the dispute remains unresolved, you or XYZ may submit the dispute for review by a council of XYZ dealers organized in accordance with the Operating Manual (the "Dealer Council"). Unless otherwise specified in the Operating Manual, the opinions of the Dealer Council will be non-binding; (iii) If the dispute remains unresolved after review by the Dealer Council, you or XYZ may submit the dispute for review by the village chief of the village identified in Section [ ], in accordance with the procedures in the Operating Manual. If the village chief has a personal interest in the dispute, then you and XYZ must designate another prominent individual who does not have a personal interest in the dispute. Unless otherwise specified in the Operating Manual, the decision of the village chief will be non-binding.

Example 9: Employees and other stakeholders. The final example concerns stakeholders in the franchise other than the franchisor, the franchisee, and the customers of the franchise. Specifically, the clauses compared below address employees of the franchisee.

In the clause from the commercial contract, the franchisor disclaims all responsibility for employees working in the franchise. Similar clauses have long populated commercial franchise agreements, but in recent years they have been buttressed and refined as a result of developments in employment law, primarily (but not only) in the United States. Commercial franchisors now face serious

liability concerns relating to employees of the franchisee if they do not clearly hold those employees at arm's length.

The clause from the social franchise agreement goes in a starkly opposite direction. In it, the social franchisor takes an active role by imposing an obligation on the franchisee to treat his or her employees according to certain standards. Imposing this obligation is not essential to the social franchisor's primary mission of making safe, affordable drinking water available to individuals who lack access to it. However, promoting employment in the communities served by the franchisees is an intentional secondary goal of this particular social franchise. The clause illustrates how a social franchise agreement may include stakeholders in a way that a commercial franchise agreement never would.

Commercial franchise	Social franchise
You have sole responsibility for all employment decisions and functions relating to the Restaurant, including but not limited to decisions related to recruiting, screening, hiring, firing, scheduling, training (other than the training in Section [ ]), compensation, benefits, wage and hour requirements, recordkeeping, supervision, safety, security and discipline of employees. Any information we provide about employment matters, whether voluntarily or in response to your request, and whether directly or by means of any technology tools, is a recommendation only and not intended to exercise control over the wages, hours or working conditions of your employees or the means and manner by which they carry out their duties. You alone will direct and control all employees of the Restaurant, subject only to the Brand Standards that we prescribe to protect the goodwill associated with the Marks. You must clearly inform all workers, before hiring and periodically thereafter, that you, and not ABC, is their employer and that ABC does not assume and will not accept any employer, co-employer, or joint employer obligations. You agree to indemnify us, as provided in Section [ ], against any claim that ABC or any affiliate is the employer, co-employer, or joint employer of Franchisee, its owners, or any your workers.	Maintain employment and customer service practices that reflect XYZ's social mission, Code of Ethics, Customer Experience Requirements, and brand emphasis on a healthful quality of life. Franchisee agrees to promptly issue an employment contract to all employees that provides for a fair living wage, reasonable working hours even if the business is closed on Sundays, and other benefits that reflect well on the reputation of the Franchise Business. Franchisee is strongly encouraged to implement a 'success sharing' program to build a team environment that incentivizes and rewards all employees. Franchisee agrees to treat employees, contractors, vendors, customers and anyone else in a business relationship with the Franchisee fairly and ethically with the utmost respect.
Except as expressly provided to the contrary herein, nothing in this Agreement is intended, nor will be deemed, to confer any rights or remedies upon any person or legal entity other than Franchisee, the Owners, and us, and such of their successors and assigns as may be contemplated by Section [ ] above.	

The foregoing social franchise agreement clauses bear out the prior observation that much of what Hart and his co-authors have to say about formal relational contracts resonate when applied to social franchising. The sample clauses illustrate use of the franchise agreement to align the social franchisor's and its franchisees' interests around advancing the mission of the social franchise. The

mission-supporting language ranges from mere reminders of the shared mission, to outer limits on the exercise of discretion, to enforceable action items. These relational characteristics, as previously noted, differentiate social franchise agreements from their commercial cousins.

This side-by-side comparison of contract terms comes with some caveats. First, it is by necessity selective. Not all of the provisions described in this article will be in every franchise contract, and franchise contracts will include provisions not discussed here. Relevance of the examples chosen will vary based on the nature of the activity taking place on the ground where the social franchise is operating. However, the examples aggregated here can help inform a social enterprise's approach to other provisions relevant to its social business. The social enterprise can then design contract terms from the outset that are appropriate for its program and incentivize franchisees to adhere to the social goals.

A second caveat is that in franchising, the "governing documents" are not just the franchise agreement itself. They also include the operations manual, the franchisor's brand standards, the franchisor's monitoring and enforcement program, possibly a trademark style guide, and a hundred other details not expressed in the body of the franchise agreement.[95]

Commercial franchisors nearly always rely on operations manuals external to the franchise agreement to fill in the details of broadly stated contractual obligations.[96] Commercial franchise agreements typically refer to the manual dozens of times, by their terms obligating franchisees to comply with the requirements found in the manual—which the franchisee typically does *not* see before signing the franchise agreement. The documents are built this way to allow flexibility for the franchisor to make changes in its operating standards without having to amend the franchise agreement. This practice, although standard, raises interesting questions about just how far the franchisor can go in imposing new or changed requirements through the operations manual.[97]

---

[95] In many domestic and foreign jurisdictions, the governing standards also include statutory provisions that override the terms stated in the franchise agreement. *See e.g.*, Cal. Bus. & Prof. Code § 20000 – 20043 (West 2019); Malaysia Franchise Act 1998, Act 590, given Royal Assent Dec. 24, 1998.

[96] *See e.g.*, David A. Beyer et al., *Changes in System Standards – What is the Extent of the Franchisor's Latitude?*, A.B.A. 35TH ANNUAL FORUM ON FRANCHISING (2012); Amy Cheng et al., *Operating Manuals – The Devil is in the Details*, A.B.A. 31ST ANNUAL FORUM ON FRANCHISING (2008).

[97] Some courts have been remarkably supportive of broadly interpreting the authority that can be exercised through a general obligation to comply with brand standards or the operations manual. *See e.g.*, Burger King Corp. v. E-Z Eating, 572 F.3d 1306, 1308 (11th Cir. 2009) (imposing maximum prices on franchisees was within franchisor's authority under clause stating that franchisee "agrees to accept and comply with such modifications, revisions and additions to the [franchise operating manual] which [the franchisor] in the good faith exercise of its judgment believes to be desirable and reasonably necessary"); Bores v. Domino's Pizza, 530 F.3d 671, 673 (8th Cir. 2008) (mandating purchase of computer system from franchisor and designated manufacturer did not breach franchisor's obligations to provide "specifications" for a computer system and to permit franchisees to purchase hardware and software "from any source"; the term "specification" can mean a finished product and "any source" means any available source, of which there was only one).

The existing literature, as well as social franchise support organizations, often encourage social franchisors to mimic the commercial approach by writing operations manuals capturing the know-how and standards associated with their business model. There is good reason to follow this advice—after all, the social enterprise cannot achieve scale if it cannot both package and effectively communicate the knowledge that enables others to replicate its model. Moreover, many social franchisors operate in challenging environments where the need for flexibility to update standards and requirements is even more intense than in commercial settings. The solution offered by the operations manual approach is therefore a crucial tool for social franchises as well as commercial ones.

Still, it is important to recognize that the operations manual, like the franchise contract provisions analyzed above, may require a different spin in the social enterprise context. Again, in commercial franchising, the contract/operations manual structure was built to allow flexibility *for the franchisor*—not for the franchisee. It is fair to consider whether the operations manual, like the contract provisions discussed above, should be written differently for social enterprises that sponsor social franchises. Should it cover topics that the commercial operations manual does not—such as interactions with stakeholders not found in the commercial context? Should it include different processes for issuing changes to the manual, rather than unilateral revision by the social franchisor, so that the manual better reflects the mutual interests of the parties? Perhaps there is a need to incorporate flexibility for the franchisee as well as the social franchisor, such as tolerances for deviation from brand standards that a commercial franchisor would not permit.

A third caveat to the comparative contract terms analysis is the evolving nature of the franchise agreement within any given franchise system. Most commercial franchisors revisit their franchise agreement templates every year and tweak the terms continuously. The most common drivers of change are new technology, new products and services, disputes or experience that have identified gaps, and changes in the law.[98] These forces, of course, are not unique to commercial franchises; constant change is or will be the norm for social franchise agreements too.

These caveats illustrate the extent to which franchise agreements, both commercial and social, are often purposefully "incomplete." Furthermore, as our comparison of terms found in social franchise agreements suggest, social franchise agreements also share many of the characteristics of formal relational contracts as recently described by Hart and his co-authors.

Hart and his co-authors identify five steps that they believe are necessary to negotiate a formal relational contract: (1) lay the foundation, (2) co-create a shared vision and objectives, (3) adopt guiding principles, (4) align expectations

[98] In recent years, examples of drivers that require changes in common franchise agreements have included integration of mobile applications into business models, adoption of domestic and international privacy laws, increased liabilities associated with breaches of data security, shifting standards on "co-employer" and "joint employer" concepts, and attacks on so-called "no-poaching" clauses (which restrict hiring away employees of other franchised outlets).

and interests, and (5) stay aligned.[99] To illustrate how to put these five steps into practice, they provide a short case study of a negotiation between a large physicians practice and a major healthcare system. However, we think it would be difficult to apply the same process to negotiating a social franchise agreement. Hart's case study involved the bilateral negotiation of a single, long-term contract between two parties with relatively equal bargaining power. By contrast, in a social franchise network, the social franchisor will enter into not one, but potentially dozens of parallel relationships, and not all at once, but over time as the social franchise network grows. In those circumstances, does it fall to the first franchisee to develop the relational aspects of the franchise agreement on behalf of all franchisees to follow? It seems the answer to this question should be "no" if there is to be authentic co-creation of terms between the social franchisor and each of its social franchisees. But how can a social franchisor work out a separate relational contract with each franchisee as the franchisee comes on board? Wouldn't that sacrifice the very contractual consistency and transactional efficiency necessary for replicating the social enterprise's brand through a business-format franchise approach? Accordingly, some adaptation of the five-step methodology proposed by Hart and his co-authors for achieving a formal relational contract seems necessary if it is to be used for social franchising.[100]

We suggest that direct negotiation—party to party—is not the only route to developing a formal relational contract. Rather, a social franchisor could intentionally follow the five-step methodology in developing its own form of social franchise agreements unilaterally, then socialize its approach within a given market with prospective franchisees as part of its market-entry due diligence, and, finally, once operational in a market, refine the contract over time through iterations with incoming franchisees. Alternatively, the social franchisor could negotiate the terms of its social franchise agreement with a committee representing all franchisees.[101]

No matter which approach is taken, however, we believe the social franchisor still would need to give special attention to the establishment of contractual governance structures that aim to maintain an alignment of the interests of the social franchisor and its franchisees over time. Hart's case study indicates that a key piece of its success was negotiating a framework for jointly resolving problems and reaching consensus about necessary changes to be taken during the course of the relationship. As noted above, we believe similar negotiations are unlikely in the formation of a social franchise agreement as the social franchisor typically will not have a counterparty franchisee pushing the social franchisor to

---

[99] Frydlinger et al., *supra* note 68, at 122-25.

[100] While we focus here on social franchising, these same issues would arise in commercial franchising too.

[101] This collective bargaining approach to developing the franchise agreement is essentially what happened in the case of The Impact Hub. *See* Giudici et al., supra note 9, at 13 ("In February 2010, around 50 people gathered in Amsterdam to discuss the challenges surrounding the franchisor's business model . . . . In the end, most participants decided to establish a working group with key stakeholder representatives to explore and propose a new business model . . . . The final approved business model created a new central organization, 'Hub Association,' in the form of a nonprofit entity collectively co-owned by all local hubs as equal shareholders.").

share control of decision-making. Therefore, the social franchisor must be self-motivated and intentional about building a framework that provides sufficient incentives for future franchisees to maintain an alignment of their interests with that of the social franchisor in particular and the social franchise network more generally.[102]

One tool the social franchisor might intentionally choose is the formation of a franchisee council to facilitate communication and mutual problem-solving. A full treatment of franchisee councils is beyond the scope of this article, but it is important to highlight how they, too, may play out differently in the social franchise context versus a commercial franchise. In commercial franchising, franchise councils are rarely provided for in the franchise agreement and are almost always designated as "advisory" in nature. Typically, the commercial franchisor is free to veto council recommendations, to change the structure of the advisory council, and even to dissolve it unilaterally. These characteristics sometimes lead to accusations that the advisory council is a rubber-stamp, captive body of the franchisor and so does not truly represent the views of the franchisee community.[103]

A social franchisor, in prioritizing alignment of interests in advancing the social mission of the network, will approach franchisee councils differently than does a more commercial-oriented franchisor. Consider, for instance, Example 8 of the comparative analysis of franchise agreement terms above. In the sample social franchise agreement's clause, the Dealer Council is built into the contractual dispute resolution structure – its role (even if not its decisions) is a binding commitment of the social franchisor. One can easily envision a broader contractual governance structure that, like the one in the Hart case study, requires the social franchisor and its franchisees to "meet[] at regular intervals to review progress against the shared vision, goals, outcomes, and measures."[104]

Building this framework is likely to be more challenging for trade-off franchise networks than for lockstep franchise networks, because the financial interests of the social franchise and its franchisees may be misaligned, perhaps even more so than the misalignment found in a commercial franchise relationship.

---

[102] To this point, as has been noted by Eric Posner in his article, *The Regulation of Groups*, "[f]or any given area of endeavor, cooperation is likely to displace independent action or defection when the cooperative surplus [difference between cooperation payoff and defection payoff] is high, the cooperation cost is low, the probability of being detected and sanctioned upon defection is high, and the severity of the sanction for defection is high." Posner, *supra* note 93, at 133 (Posner takes no position on whether emotional fulfillment should be counted as part of the cooperative surplus, but he notes that others have suggested that participation in decision-making increases parties' willingness to act cooperatively).

[103] In practice, franchise advisory councils vary widely in terms of the circumstances in which they are formed. For example, an advisory council might be formed in response to a specific system-wide business challenge (such as a technology overhaul) or in an attempt to stave off the formation of a hostile independent association of franchisees. Advisory councils also vary in size, degree of formality, selection of members (e.g. appointed by the franchisor versus elected by franchisees), eligibility to participate (e.g., exclusion of franchisees who are in default or in litigation with franchisor), meeting frequency, agenda control, etc.

[104] Frydlinger et al., *supra* note 68, at 125.

On the other hand, where mission and profits go hand-in-hand, as contemplated by a lockstep franchise, it should be easier for the social franchisor to accept delegating some decision-making to its franchisees.

V. CONCLUSION

Not every social enterprise is franchise-ready, nor should it be. But for those that are, franchising can provide an effective path to scale, as the pioneering mother of franchising, Martha Matilda Harper, demonstrated long ago.

The do-good missions of social franchises, however, do not inoculate social franchise relationships from many of the commitment problems and related conflicts of interest that also challenge commercial franchises. The inherent tension between the top line orientation of the commercial franchisor and bottom line orientation of its franchisee is likely to shape and complicate social franchise relationships too. Indeed, there may be even more tension in the social franchise relationship, particularly in the trade-off franchise networks, due to potentially competing interests of profits and purpose. As Hart has noted, "[w]hen doing good is making money, it's simple – but doing good isn't always the most lucrative decision, so what then?"[105]

Accordingly, the social franchise relationships that are forged by social enterprises seeking to scale are likely to be complex, perhaps just as complex as the social and environmental problems that gave rise to the creation of the social enterprise in the first instance. Yet the agreements that social franchisors enter into with their franchisees need not be similarly complex. Rather, social franchise agreements, like more commercial franchise agreements, can benefit from being intentionally incomplete.

On the other hand, strict adherence to commercial franchise contracting norms—be it in social franchise agreements or operating manuals—is likely to be counterproductive to the broader goals of a social franchise. Rather, formal relationship contracting, which builds on a foundation of trust and mutual self-interest, and requires contracting parties to articulate a shared vision and guiding principles for their conduct, seems more likely to align the interests of social franchisor and franchisee in the durable pursuit of scaling both profits and purpose.

Many of the necessary elements of a formal relationship contract eventually show up in social franchise agreements, as our comparison of contract terms illustrates. But over-reliance on commercial franchise contracting norms at the outset can slow or even derail the alignment process. This caution is pertinent to all of the contractual tools used in social franchising, not just the social franchise agreement, for there is a risk that wholesale adoption of the other contractual tools of franchising, such as the operations manual, can undermine much of what was gained by taking a formal relational contract approach in the social franchise agreement.

---

[105] Oliver Hart, *What's the social purpose of a company?*, UBS NOBEL PERSPECTIVES (Oct. 12, 2018).

This article concludes on an optimistic note. Social franchising offers an opportunity to re-examine the franchise relationship and look for new and effective ways to align and maintain an alignment of franchisor and franchisee interests. In doing so, the drafters of social franchise agreements have the potential to shape new contracting norms for social enterprises seeking to scale through franchising, and perhaps even inform the contractual underpinnings of a host of other franchise relationships that could stand to benefit from a better alignment of interests.