

August 2, 2007

To: The UPS Store Franchise Network
Re: What the BBOA stands for.
Please take the time to read this letter. The future of our Network is at stake.



Dear UPS Store Franchisees:

I am communicating with the UPS Store franchise network to appeal to the thousands of store owners we believe are passionately committed to the success of the UPS Store network, but who are increasingly concerned by challenges to our success and existence. The Brown Board was organized by concerned UPS Store owners who are intent on engaging UPS and MBE to collaboratively work to increase the performance, value and profitability of our system and brand for the mutual benefit of UPS and individual store owners.

Who is the Brown Board

Although many owners know of the Brown Board Owners Association (BBOA), many are not aware of our purpose and goals, and how your support can help power our ultimate success in your behalf. Indeed, quite often we are confused with other independent UPS Store associations. It is for this reason that I take this opportunity to outline our issues and concerns in detail, and to restate our objectives and goals.

Let me begin by stating categorically: The BBOA is dedicated to forging a profitable business model and a great franchise relationship through a collaborative effort with MBE and UPS. We seek negotiation, not litigation, to achieve relief for a large percentage of the UPS Store network.

We are aware that some store owners who are pursuing litigation have formed their own association, namely the Brown Shield Association (BSA). We understand that the BSA has retained counsel to pursue a lawsuit for the purpose of seeking independence from MBE and UPS and recovering damages against UPS. While many BBOA members may share similar concerns with our BSA brothers and sisters, our focus is on solutions that repair and preserve the UPS Store brand.

It is the intent of the BBOA to represent Owners in a professional manner by working directly with our Franchisor, to strengthen our brand awareness, grow our investments, maximize our profits, and better serve our customers.

The BBOA Supports the MBE Sanctioned FAC Committee

We are also aware and recognize that The UPS Store network has established a FAC Committee to represent franchisee interests. We respect our elected FAC representatives and admire their dedication to support UPS Store franchisees. The BBOA communicates frequently with

members of FAC, some of whom are also members of the BBOA, and one of our purposes is to support the effectiveness of the FAC. However, we also recognize that the FAC sits at the pleasure of UPS and MBE, and lacks independent resources to engage research, hire counsel and consultants, and to adopt initiatives to affirmatively support independent store owners.

While an effective FAC is an important tool for communication, an independent owners association can build the resources to affirmatively provide benefits of value to Store Owners, and to provide resources and support for the FAC leaders. Our collective experience provides us with a wealth of knowledge. As an Association, we have greater ability to address issues important to our business, to funnel owner concerns and experience to elected FAC members, and to affect the overall value and continued viability of our investments.

The UPS Package Handlers and Loaders, as well as the UPS Pilots, have each formed groups to better represent their respective interests. It is likely that each of these groups has concerns that are unique to their respective group. **So do we!** The BBOA is a collective group of UPS Store Owners who are working to make sure that our issues and concerns are also heard and addressed.

A Strategy to Achieve Mutual Respect and Success for UPS and UPS Store Owners!

While much of this position paper is intended to detail the issues and concerns that bring us together, it is essential that we stress that our strategy for success is based upon our understanding and respect for the success of UPS and MBE and our conviction that our mutual success is a necessary ingredient to a strong and vibrant UPS Store network. We are convinced that a strong and profitable network will serve UPS' success and profitability, and that a stressed and economically challenged network will have the opposite result, negatively impacting our common enterprise. Thus the BBOA intends to pursue a strategy of serving the legitimate needs of UPS and MBE in exchange for respect for the needs and success of the independent UPS Store owner.

Although profitability is the BBOA's major concern, the scope of our service and support is not limited. As a collective body we can address marketing needs, the enhancing of customer service, vendor resources, product and profit center development and the overall profitability and growth of our UPS Franchise network.

It is up to us, the Store Owners, to protect our investments. Individually we are limited. We are convinced that collectively, we Owners can effectively guide the growth of our stores and our investments.

Issues and Concerns all UPS Store Owners Share

One of the purposes of an effective owners association is to share ideas and concerns for our mutual benefit. While we are still in a mode of listening and learning from each other (including listening to UPS and MBE), the BBOA has discerned a common thread of significant initial concerns raised by our members. One of the purposes of this paper is to validate those concerns



with the broader population of store owners. We encourage and welcome your feedback. Some of the concerns and issues identified include:

1. Margins on Shipping Revenue

Analysis of data from our Royalty Reports indicates that there has been a shift in our Stores' business mix. Revenues from shipping have increased significantly to become the majority of our business, however, the profits from these increased revenues have markedly decreased. That revenues are mostly from shipping is not surprising, since our Store sign says "UPS," and (as far as the public is concerned) UPS = Shipping. Ironically, of all our profit centers, shipping yields the lowest profit margin. Why? Because UPS establishes both our shipping costs as well as what we must sell these services for, via the CMS system. In this CMS system, we Owners believe there is a serious flaw: UPS controls our margins for a major part of our revenue stream. Thus, when the system calculates what the customer is to be charged, there is no recognition or allowance for differences in regional demographics and/or economic conditions. We are aware of no other franchise that places these pricing restrictions on their franchisees. We also have a problem with UPS being able to change surcharges on shipments without notification. In every case the incentive to the store is not in proportion to the increase, thus further reducing our margins.

2. Overall Store Profitability is a Major Concern.

The majority of UPS Stores do not start breaking even for 36 months with many requiring 48 months or more. That does not mean that the owner(s) have made their money back in 36 months, it means it takes the average store 3 years before the owners stop putting more money into the store. Unfortunately neither MBE nor the Area Franchisee tells this to the prospective buyer. Generally, this means that opening a new store **is a bad financial decision.** The average store is resold when the original owner runs out of the cash needed to continue operations, then the second or third owner has a chance to start making an income. **It is almost always better to buy an existing store!!** Some stores start to produce a \$35,000/yr income for the owner at about \$365,000 in annual gross sales, but the medium store gross sales at present appears to be about \$280,000 (available numbers say about 60% of all US stores do not break even). Taking an example from the PACE manual, it states that a store that does \$550,000 STR with a 60% margin should gross about \$110,000 in profit. To simplify the math, they take \$550,000 and multiply by a 60% margin. Fixed and Variable expenses are estimated to be \$220,000. **However,** if you multiply by 52.5% (the average gross margin according to Financial Planner), gross profit is reduced by \$41,500 (to \$68,500). This is a ridiculously small return on investment for a store that is in the top 5 to 10 percent of the network.

3. UPS Has Become Our Largest Competitor

UPS has effectively reduced our profit margins by offering substantial discounts to any small business that applies for a six digit UPS account. It costs that potential store



customer less to ship directly than in-store. The result is that the shipping mix is changing to **decreased in-store processing and to increased drop-offs.** For drop-offs, the Store receives only a small commission, as compared to shipping manifested by the Store. Example: Assuming an average shipping cost of \$10.00, UPS keeps \$8.90, and the Store receives \$1.10 or 11%. Can a Store make a profit on such a low margin? For larger, heavier packages the commission is slightly greater but the percentage profit for the store is even less. UPS' yield (what they make per package) is achieved at no cost to them, since they fix our cost of shipping as well as our selling price. UPS had recently adjusted the on-line rates to the public to match the store's retail rates. However, this was recently negated by UPS offering discounts of up to 31% to EBay sellers and other discounts to shippers who ship as little as \$50.00 per week

4. Royalties are subjected to "Double-Dipping"

UPS not only receives a margin on our shipping revenues, but moreover, through royalties UPS also levies our sales, including those commissions mentioned above. We refer to this as "double-dipping." Example: Assume that the shipping of a UPS ground package retails for \$100.00. With the Store incentives, it costs the Store \$55.00 to ship it. The Store then pays 8.5% royalties on the \$100.00 retail price. Therefore, the real cost to the Store (the amount UPS/MBE receives) is 63.5%. Our effective incentive is actually 36.5%, **compared to the 45-49 %, as touted by UPS.**

5. UPS Could Help the Stores Profitability By Exercising Its Purchasing Might

All Stores would be more profitable if UPS would put its purchasing power into effect on the Stores' behalf, rather than allowing MBE to reap the benefits of discounts. Case in point: MBE forces the Stores to purchase computers from them, at a cost that is substantially higher than they can be bought on the open retail market or by dealing en-mass with specific vendors.

6. The Present UPS Gold Shield Business Plan is Flawed

From the point of view of the Store Owners, it seems counter productive to operate under a plan whereby a Franchisor is in competition with its own Franchisees. Does it make sense for the Store Owners to be operating under a Franchise Agreement that is so one-sided that many attorneys experienced in franchise law refer to it as "unconscionable" and which received such a low grade when compared with AAFD's franchising standards?

7. The Health of the UPS Franchise Network is Not Sound.

MBE executives tell us that the number of stores that are forced to close their doors is small (1%). We recognize that it is normal to see some stores fail. However, to accurately determine the true health of the network, it is necessary to look beyond the number of Store closings. Many new Store Owners who purchased their respective franchises spent upwards of \$200,000 to open their doors. However, after two to three



years of no profits, and the need to inject additional funds, many of these same store owners have had to close their stores (and were only able to sell them for \$30K to \$60K). MBE classifies such forced-to-close Stores as “Transfers,” a practice that candidly we view as false and bordering on unethical.

Does this, in fact, indicate a significant problem with the franchise model? This situation would be quickly apparent if some questions were raised:

- (a) In the last 18 months, how many Stores have been resold vs. new Stores opened?
- (b) What did the average (so-called) “Transfer” store sell for within that 18-month period of time, as compared to a 18-month period two years ago?
- (c) Ask MBE to show UPS the number of new Stores that have opened in the last 6 months. Compare that number to the three 6-month periods prior to the most recent 6-month period. Analyze the trend.

We believe that UPS will see a significant decrease in the number of new Stores opening. What caused the decrease? MBE and UPS will claim that it is due to the negative publicity generated by the various lawsuits. Maybe. Perhaps recent prospective franchisees have sought information from existing Store Owners, or have logged into the various related Web sites which will tell them the truth: namely, that the future of the franchise looks bleak and that there is very little profit in it for the investor.

8. Area Franchisees Have a Potential Conflict of Interest

A related issue involves what some concerned Store Owners perceive as a potential conflict of interest—namely, that Area Franchisees receive more money for opening New stores and for the sale of so-called “Transfer” stores than they receive from building the revenues of existing Stores. Thus the Area Franchisees profit, regardless of whether a Store succeeds or fails.

9. We Are Also Concerned About New Store Placement.

New Stores have been placed in close proximity to existing stores. In many cases, they cannibalize customers from existing stores. This has happened at an alarming rate. There are numerous examples wherein the limited customer pool is insufficient to support either Store. UPS, MBE, and the Area Franchisee all receive their revenue from top-line sales; Store Owners receive their income from the bottom line. Many Store Owners are asked to assume increasingly more risk, while the benefits accrue to MBE, UPS, and the Area Franchisee. To enhance profit opportunities for new Stores, while retaining profitability of existing Stores, we ask that a different process be implemented regarding new store placement. Important: Owners of existing Stores are in the best position to accurately estimate the size of the customer base, and should be consulted when considering the placement of additional stores in their general area. Growth trends and revenues should be analyzed to determine whether or not the growth is beginning to



“plateau” based on the existing customer base. Stores closing because of loss of profit (or for any reason) hurts the UPS image.

10. The Number of Packages Processed Through the Stores Manifest System Has Decreased
According to our information, the number of packages processed through the Stores has decreased virtually everywhere in the Franchise network over the last 12 to 24 months. This is a direct result of UPS’ aggressive Internet shipping strategy and its attempt to sign up even the smallest shipping customer, and giving them their own 6-digit account number. **The number of packages processed through the Store’s manifest system has decreased in direct relationship to the increased number of drop-off packages brought into the Store.**
11. Beware of ADL. This program will undoubtedly be put into effect as soon as the UPS Union contract is resolved. This may or may not benefit the stores and will depend on whether UPS attempts to pay us as little as \$1.00 per day to assume the liability and responsibility for making our stores mini-hubs for package pick-up.

Our Issues Have Possible Solutions!

UPS may ask for suggested solutions to the above. Our purpose is to open a positive dialogue aimed at win-win solutions, and as noted above, an important aspect of a franchisee association is to gain from the collective wisdom of its members. Again we solicit and welcome input from all members (and all sources) regarding possible solutions. Nevertheless, some possible solutions include:

- (a) Modify the UPS shipping program to potentially reduce UPS’ cost of pick-ups through a restructure of online costs to more realistically reflect the cost for a manifested package at a store. Increase the commission paid to the Store for packages paid through the Internet by the same amount as the increase to the customer due to pick-up fees. This will encourage those customers who wish to avoid the pick-up fee to drop off packages at a Store. The result is increased revenue for the Store with NO additional cost to UPS.
- (b) Immediately activate the promise made to Store Owners to eliminate the 6-digit accounts for small customers and provide an incentive for them to use The UPS Store. (Note: we had been assured that customers who shipped less than \$100 to \$200/week would be directed to The UPS Store, in lieu of their being assigned 6-digit accounts.)
- (c) Improve the UPS Store retail margins. Currently, each Store is provided with a discount that is less than a UPS account doing approximately \$100 thousand per year in shipping. Margins would dramatically improve if UPS Stores were given pricing available to UPS’s largest customers. In fact, the



aggregate of all of the UPS Stores ship approximately 5 Million packages per year, likely more than \$50,000,000 in annual sales. There are many UPS customers, e.g., ReMax to name just an isolated example, who receive better pricing than UPS Stores, and we are likely UPS's largest shipping customer.

- (d) More effectively compete with Fed-Ex and the USPS, plus increase the bottom line for UPS and the Stores. How? By lowering the Stores' retail costs thereby increasing the Stores' shipping incentives, equivalent to those of a UPS account that ships \$50,000,000/year. Treat the Stores as partners rather than mere customers.
- (e) Eliminate "double dipping" by UPS and MBE by excluding the cost of shipping from Royalties.
- (f) The UPS Store Franchisees are required to participate in the "Corporate Retail Solutions" (CRS) program. In this program, UPS directs its customers to UPS stores for a transaction. It sounds like a win-win. Unfortunately, in many transactions it has become a win for UPS but a loss for the Store Franchisee. UPS dictates the price that the Store Owner (Franchisee) receives. The cost of Store labor to process the transaction and the cost of materials (which is frequently higher than allowed by the program) is such that the program often costs the owner rather than result in profit. (Owners have found themselves performing 20 minutes worth of work for less than \$2.00, thus they are working for \$6.00 per hour) Evidently, UPS has transferred its costs to the Store Owners (Franchisees). We believe that the Owners should have the option to participate, or not to participate, with each account that falls under the CRS umbrella.
- (g) Institute a new program that would have attractive benefits for UPS' large corporate customers (similar to the Fed-Ex/Kinko model). Allow the large UPS 6-digit account customers to charge anything they want at The UPS Store and have it billed directly on their UPS account. The UPS customer could charge packing services, shipping, mailbox services as well as any document services they require. With this convenience, however, the customer would not receive their standard UPS discount. They would receive regular counter rates of The UPS Store. But the billing would go directly on the accounts of the large, 6-digit customers. These charges would simply be deducted from the Store's weekly UPS bill and passed on to the corporate customer's bill.

We Hope for a Win-Win Solution for All Parties

UPS Store Owners, especially members of our Brown Board Owners Association, still have hope that the franchise business model can be modified so that both parties (UPS and the Store



network) can benefit from the relationship. The model, however, must be a balanced situation for the Store Owners, as well as for UPS.

We are all proud of the UPS brand name and have no desire to cause any harm to the image of UPS. We believe that several benefits can accrue to UPS, via a good faith dialogue with the BBOA:

- Establishing a working relationship with a group (the BBOA) that can help to effectively offset the wide-scale negative publicity from the present litigious environment.
- Increased revenues from a re-energized, loyal Franchise Store network, motivated by a collaborative and balanced relationship between UPS and the Store Owners (Franchisees)
- Enhanced position of UPS as the pre-eminent leader in the Shipping and Franchise industries by strengthening its image as a leader in ethical corporate Franchisee practices

Our Affiliation with the American Association of Franchisees and Dealers

A little more than a year ago, the BBOA affiliated with the American Association of Franchisees and Dealers (AAFD), which happens to be based in MBE's home town of San Diego. The AAFD is a national non-profit organization that is dedicated to achieving fair and balanced and successful franchise systems whose cultures are driven by win-win collaborative processes.

During the last year, the BBOA commissioned the AAFD to undertake to grade the current UPS franchise agreement against the AAFD's Fair Franchising Standards. The AAFD's Chairman, Bob Purvin, has provided guidance to the BBOA Board, has helped us to open our lines of communication with the FAC committee, and has helped us to quietly begin the process of communication with UPS and MBE.

With the AAFD's direct help, we are working to convey our concerns as well as our passion to work toward solutions, directly to UPS and MBE management.

We Can, With Your Support, Make a Difference

Our success in great part depends upon how much support we receive from you, our fellow UPS Store owners. **Indeed, our success is your success. We need your membership** in order to demonstrate to management that we have earned the right to represent you because we represent an important percentage of store owners. Above all, we must convince management that we are passionate and resolved, and focused on positive solutions. ***Our purpose is to convince management that working with us will empower our mutual success.*** UPS may be a financial giant, but let them not forget that there is strength in numbers, especially when those numbers are



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made up of “little guys” appealing to public opinion: For the overwhelming majority of consumers, The **UPS Stores “ARE” UPS.**

On behalf of our Board of Directors as well as our member Stores, I thank you for your interest in our organization and for your important and necessary support for the BBOA. If you are not already a member, please go to our website at www.thebrownboard.com and sign up today. If you have any questions or suggestions please sent them directly to me at rodr0823@netscape.net.

Best regards,



Michael J. Rodriguez, PhD
Chairman & CEO
Brown Board Owner’s Association, Inc.



THE BROWN BOARD

STORE OWNERS UNITED
IT'S UP TO US!

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