International franchising: Important considerations

With increased economic globalisation, as well as economic shrinkage in domestic economies, many businesses, large and small, have been seeking new (and hopefully greener) pastures, beyond the borders of their home countries. For businesses, particularly in the retail, hospitality and services sectors, seeking to expand, franchising is an attractive option and offers several benefits over the standard direct investment models of expansion. A franchisor entering a new market will often face certain new challenges in addition to those generally faced when franchising a business format domestically, such as:

- "Indigenisation" or other laws restricting foreign ownership of local businesses, may present an absolute block, or present a considerable administrative burden, to the establishment of an owned subsidiary in many jurisdictions.
- The capital outlay requires establishing a complete business infrastructure in a distant location. This will be carried, at least partially, by the local franchisee or franchisees.
- The unfamiliar local circumstances, including the legal system, business culture and economic environment, which will be, literally and figuratively "foreign" and different to those in which the brand has previously operated and enjoyed success.

Franchisors looking to expand their businesses into new markets need to be alive to these challenges. In order to cater for them, different types of arrangements have been used in international franchising. These typically take one of three forms:

- Area development agreements, in which the franchisor grants the franchisee the right to set up multiple franchise outlets, but not the right to sub-license to other franchisees.
- Master franchising agreements, in which the franchisor grants to a sub-franchisor or master franchisee the right to sub-license to franchisees within a given territory.
- Joint ventures, in which the franchisor enters into a joint venture with a firm based in the country in which the franchisor wishes to expand.

Each of these forms of relationships raises various issues that franchisors and their advisors need to take into account.

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In area development agreements, the franchisee will be given the right to open and operate multiple franchise outlets under license directly from the franchisor. Important issues to consider would be whether the franchisee will be required to meet target numbers, either of turnover generated or of outlets opened, and what the consequences will be if these are not achieved. They could range from cancellation of the agreement to a loss of the exclusive right, the franchisor then becoming entitled to appoint other franchisees in the territory.

In a master franchising agreement, the issues to consider include:

- The fees payable by the master franchisee to the franchisor. These could include an upfront license fee in respect of the right granted to the master franchisee, as well as a share of the revenue realised by the master franchisee from each unit franchisee that it signs up. Alternatively, the unit franchisees may pay their royalties directly to the master franchisor, which will pay the master franchisee a commission or service fee for each unit franchise it signs up.
- The respective responsibilities of the franchisor and master franchisee. These would cover issues such as unit franchisee recruitment, site selection, training and ongoing support for franchisees, as well as marketing of the brand in the territory. Part of the attraction of a master franchise arrangement for the franchisor is that its capital outlay is reduced to the extent that these obligations are taken on by the master franchisee. It is therefore in the franchisor's interests to ensure that the master franchisee takes responsibility for as much of the local marketing and administration as possible, but it is also important that the franchisor maintains control over the manner in which its brand, know-how and trademarks are exploited in the territory. The master franchisor may, in this regard, retain a right of approval in respect of each unit franchisee that the master franchisee might wish to appoint and insist on regular reports and audits of the master franchisee's business.

- Whether the master franchisee is required to achieve target numbers of unit franchises opened, sales, etc.
- Whether the master franchise will be entitled to operate individual outlets in its own name in the territory and what the fees that it will have to pay.
- The period for which the agreement will endure and whether either party will have a right of renewal.
- The arrangements on termination; for example, will the franchisor be obliged to purchase the master franchisee's business on termination of the agreement?

In a joint venture agreement, some of the questions to be addressed are:

- What will the precise nature of the relationship be; will the parties form a joint venture company, carry on business as a partnership, or will the joint venture take some other form?
- What assets, tangible or intangible, will each party contribute, who will own them while the joint venture lasts, and how will they be distributed on dissolution?
- What rights and obligations does each party have in respect of the intellectual property and confidential information belonging to the joint venture, both during the period that it endures and thereafter?
- What responsibilities will each partner have in respect of management and control?
- How will deadlocks and disputes be determined?

In structuring an international franchise, it is important for the parties to recognise the particular changes posed by the multi-national nature of the relationship. It is important for both parties that the rights and obligations assumed by each of them are valid and enforceable by each of them and in the jurisdictions where each of them carries on business. The franchisor will have developed its concept in its local jurisdiction, and will have taken the necessary precautions to protect its brand and intellectual property there. However, this will not necessarily mean that it will be protected in other territories, or that the obligations that it will require its franchisees to take in those territories will be enforceable. International legal advice in regard to the law of each territory into which the franchisor wishes to expand is essential, for both parties, to ensure that they have properly protected their investments.

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