

FRANCHISING: Is it for you



By Margaret Law

In recent years, the franchise industry in Asia has seen more activities as entrepreneurs become aware of the advantages that come with using a tried and tested business model and a recognised brand name. This trend has proven to be a popular new business model for current generation entrepreneurs.

By definition, a franchise is “an authorization granted by a government or company to an individual or group enabling them to carry out specified commercial activities, for example acting as an agent for a company’s products.” (Oxford Dictionaries Online). Essentially, it is a form of business arrangement between two parties involving the distribution of goods and/or services.

In franchising, a franchisee invests in the right to sell certain products and/or services using the franchisor’s established brand name and proven business system. In return, the franchisor provides advice, training, technical business support, advertising and promotional support and access to the key goods and services needed to operate the franchise business. Franchising allows the franchisor to enjoy brand expansion and benefit from having an additional revenue stream. To the franchisee, using a tried and tested business model greatly reduces the risks and uncertainties of starting a business.

Before entering into a franchise arrangement, both the franchisor and the franchisee must evaluate their finances and business objectives as well as carry out proper due diligence on each other. The legal framework for franchising should also be considered to ensure that the franchising laws in the relevant countries are complied with.

PRELIMINARY CONSIDERATIONS

Understanding the market and its trends and conducting background checks are all routine procedures in starting a business. In franchising, there are some additional considerations franchisors and franchisees should take into account before proceeding with a franchise arrangement.

Franchisors

The franchisor must evaluate its readiness to expand and determine whether franchising is the best strategy to do so. Its business model must be easy to replicate and commercially feasible. This means that the franchisor should critically review its business model, budget, industry, operations, marketability, trade mark and trade name protection and other relevant

facets of its business for expansion. The franchisor should also carefully consider if it has the necessary resources for supporting the franchisee in training, technical business support, advertising and promotional activities and giving access to the key goods and services, without affecting its own operations and the operations of its other franchisees.

The franchisor must also select the appropriate franchising format to employ. The usual franchising formats include unit franchise, area-development franchise, master franchise and joint venture. Format-selection is affected by various factors including the financial ability of the franchisee, the experience and background of the franchisee and the extent of involvement the franchisor wishes to have in the arrangement.

A successful franchise is one that achieves a good synergy between the franchisor and franchisee. As with any business relationship, the franchisor and the franchisee must understand each other sufficiently in order for a good franchise arrangement to be achieved. From the perspective of the franchisor, it is important to carefully evaluate the franchisee’s financial capability and relevant experience in the industry before appointing the franchisee.

Franchisees

Aside from evaluating its own readiness to take on a franchise, other important considerations for the franchisee during the planning and pre-contract stages include:

- (i) the expected financial returns from operating the franchise business;
- (ii) an understanding of the franchisor’s business and experience;
- (iii) required franchise expenditures;
- (iv) the initial and on-going support that the franchisor can offer; and
- (v) the viability of the franchisor’s business model.

It is important for the franchisee to have a thorough understanding of the franchise business as he has to uniformly follow the franchisor’s established system and promote it with pride. Although the franchise business may be viable, it would still take commitment, dedication, hard work and good communication with the franchisor to make the franchise business work to both parties’ benefit.

THE PREPARATION STAGE AND LEGAL FRAMEWORK

Intellectual Property

At the preparatory stage, the franchisor should have identified, assessed and protected the intellectual property (IP) rights it intends to use in its franchise business. These IP rights include the franchisor's trade marks and trade name, operational system, training techniques, know-how and other unique methods or features of the to-be-franchised business. The franchisor should ensure that its IP is adequately protected before granting the rights to use such IP to a franchisee.



Agreements

Underlying the above business considerations is the legal framework upon which the franchise model is constructed. As with most business transactions, the franchise model is a contractual arrangement captured in writing by legal documentation. The legal documentation is usually developed after the commercial terms have been decided upon. Memoranda of Understanding and Confidentiality Agreements are often used before or during negotiations to clarify each party's position and, where knowledge may be exchanged, to protect otherwise classified information. The franchise agreement then captures the relationship, duties and obligations expected of each party as well as spells out the workings of the franchise system.

Both franchisor and franchisee should thoroughly read and understand the terms of the legal documentation involved in a franchise arrangement. Once signed, the documents become legally binding and both parties would be considered to have agreed to the contractual terms. What initial fees are to be paid? How much and when are royalties due? What are the business targets expected to be achieved by the franchisee? How, when and where will the training be held? Who is responsible for fitting out the franchise store? How will the staff be selected? Who is responsible for advertising and marketing? How often and how exhaustive are reports to be submitted to the franchisor? These, inter alia, are details which the franchise agreement will contain.

Regulations

Legal regulations have emerged alongside the increasing popularity of the franchising model. In some countries, disclosure of certain information by the franchisor to the franchisee is a requisite safety measure to protect the franchisee before the franchise agreement can be entered into. To ensure that the franchisee is making an informed decision, these disclosure requirements oblige the franchisor to reveal information about its financial situation and track records.

Some countries (for example, Singapore) do not have franchise-specific legislations and the relationship between the franchisor and the franchisee is governed contractually by the franchise agreement. In some other countries, there are franchise-specific legislations requiring the franchisor and/or the franchisee to register the franchise arrangement with specific governmental authorities. It is therefore important to seek legal advice from local lawyers in country where the franchisee is to be appointed in order to ascertain the legal requirements in the franchise regime of the relevant country.

Code of Ethics

National franchise associations have been established in many countries to govern the activities in the franchise sector. Some of these national franchise associations have issued their own Code of Conduct or Code of Ethics to provide guidance on the rights and obligations of franchisors and franchisees before, during and after the franchise arrangement is established. In countries where there are no franchise-specific laws, these guidelines occasionally prescribe the industry norms and recommend good practices such as stipulating franchise disclosure requirements.

Enforcement

Enforcement of the franchise agreement is a concern, particularly in international franchise relationships. Although the parties would have anticipated and prepared for the many eventualities, disagreements may nevertheless arise. As a contractual arrangement, the Franchise Agreement will set out the agreed form of dispute resolution: litigation, arbitration or mediation. Differing in methodology, cost and resulting impact on the relationship between the parties, the legal ramifications of enforcing the agreement should thus be carefully considered in light of the parties' needs.

DEVELOPMENT OPPORTUNITIES

As the franchise system in the home market becomes more stable, franchisors may look abroad for opportunities to expand or franchisees may be interested in pioneering a foreign franchise in their local markets. Globalisation of markets and cross-border brand awareness has made international franchising attractive. It is at this stage when language and cultural considerations come into play. A foreign market may have a different business, legal and cultural environment than the franchisor's home market. Hence, successful approaches from the home market may not be entirely suitable for the market in another jurisdiction. For this reason, conducting extensive research is a worthwhile endeavour before taking a step towards international franchising.

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Margaret's expertise lies in the area of intellectual property law. She represents a wide range of clients and regularly advises on issues concerning the protection and commercial exploitation of intellectual property. In recent years, Margaret has been actively involved in advising local Small Medium Enterprises ("SMEs") on legal strategies to enhance business development through effective protection, management and exploitation of intellectual property. Margaret is certified as a SCOPE IP consultant by the Intellectual Property Office of Singapore ("IPOS").

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