

Franchising From The Franchisors Perspective

NOTE: The following is a very brief introduction to franchising taken from the franchisors perspective and is for discussion purposes only. It does not constitute definitive guidance nor does it deal with any UK or competition law aspects, which ultimately may need consideration.

Franchising is often chosen as a way forward for existing successful businesses as a means of growing its existing business. The successful formula of how the business operates is usually laid out in an operations manual which the franchisee must follow and adhere to, and the franchisor and franchisee enter into a franchise agreement after a successful application.

The operation manual will contain a vast array of information - everything from such information as the system to be used, the equipment for undertaking the tasks, vehicle requirements, administration procedures, accounting procedures, employment policies, pricing policies, store layouts and advertising, property matters such as leasing arrangements, display and merchandising techniques and the technical support.

Using the terms and conditions of a franchise agreement and the operations manual, a franchisor will allow the franchisee to use a name (and sometimes related intellectual property such as branding and trade marks) that is associated with the franchisor and the franchisor business; exercise control over the franchisee, provide financial, technical and administrative assistance and ultimately the franchisee will make periodic payments to the franchisor.

It is important to firstly establish the reasons why the business can be grown through franchising and on what basis you think the products or services are capable of being franchised and how the franchise would be managed.

The following is a short but by no means exhaustive list of the advantages of franchising a business:

- franchising can offer a business the opportunity to secure a much wider and faster distribution for its products and/or services than would be the case if the franchisor had to train up its own employees, source suitable outlets and develop its own internal marketing, sales and distribution organisation;
- the use of a franchisee's capital will facilitate the expansion of a network more quickly than would be the case if the franchisor had to find the funds itself. You would need to consider what each franchisee would require to carry on its own business such as premises, vehicle, merchandise etc.;
- generally the franchise business will motivate the franchisee to perform as it is their business and will want to see it succeed as they will have personally invested time and money in it;
- a franchisor, by having an increased number of outlets may have an increased purchasing power and may well be able to reduce overheads, which in turn may be able to increase the profitability of smaller units particularly.
- It has also been argued that franchisors may be more likely to thrive in a recession than non-franchised businesses due to the unique model which franchises operate under.

Where there are advantages there are always disadvantages - here are some of them:

- loss of control is probably the primary disadvantage, whilst the franchise agreement can impose strict controls upon the franchisee, ultimately the franchisee is an independent third party and it is therefore important that the right checks and balances are contained within any franchise agreement and that a franchisor monitors the activities of the business and acts on the terms of any agreement;
- some of the profits of the business is being used to support the franchises, whether directly in terms of the obligations under the franchise agreement or indirectly in terms of the goodwill in your business, however where there is success this is seen as part of doing business;
- with the introduction of third parties means disclosure of your business practices which could form part of your know-how and confidential information (this is your intellectual property and your assets). While a franchise agreement will provide restrictions, you will not want to spend excessive time and effort monitoring these, nor costs in enforcing such matters;

- ultimately franchisees are not employees, and as such will require different skills as they will be running a business and you could therefore be looking for quite different individuals.

In the UK there is no single piece of codified legislation applicable to franchising and in the UK, self-regulation applies. A body called the British Franchise Association ("BFA") has been set up (*please note that there are other similar bodies in the UK, however, MacRoberts are not affiliated to the BFA or any other*) and requires its members to comply with the European Code of Ethics for Franchising (the "Code"). As such the franchisor is required to:

- have operated a pilot operation before launching the franchise;
- be the owner of all relevant brand names and trade marks to be licensed under the agreement; and
- provide both initial and continuing training in running and operating the franchise business.

The Code imposes general obligations on both parties to act fairly with each other in the franchise agreement. We understand, without compliance with the "concept" of fairness, any application to become a member of the British Franchise Association is likely to be unsuccessful.

The Franchise Agreement

In the drafting of a franchise agreement the franchisor's obligation will usually be expressed under two headings:

Pre Commencement Obligations

Such obligations are to enable the franchisee to set up and would include such matters as premises, the supply of equipment and stock, initial training programme, PR to launch business, provision of the franchisor's operations manual and site selection assistance.

Continuing Obligations

Such obligations are to provide know-how, advice and guidance, training for franchisee's employees, the contractual products, standard contracts, stationery when required, the continuation of research and development, annual conferences and the monitoring of the franchisee's performance.

While there is no single piece of legislation which deals specifically with the regulation of franchising, you should be aware that the Trading Schemes Act 1996, which has amended the provisions of the Fair Trading Act 1973 dealing with pyramid selling and a number of regulations dealing with trading schemes, are applicable in the UK. There are also competition law aspects, which require consideration.

In return for providing the right to franchise, the franchisor will receive an advance fee to enable the operation of the franchise with on-going royalty payments, which are usually based on the turnover of the franchise. Finally, as the franchise becomes more profitable and well known, your thoughts may turn to being able to sell the business onwards and the franchise agreement should provide for this at the outset.

Should you have any questions, or wish to discuss franchising as a business model that suits you, please contact:

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