



# **Economic Empowerment Through Franchising**

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# Panelists

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**The information in this presentation is not legal advice and is only intended to provide a brief overview of the franchising industry and some aspects of franchising law. The information in this presentation is not meant to be comprehensive and you are strongly advised to consult with a franchise attorney and other professionals experienced in franchising if you are considering the purchase of a franchised business.**

# What is a Franchise?

- A franchise is an arrangement between two parties which gives one party the right to use the trademark and operating methods of the other party in connection with providing goods and services.

# Elements of a Franchise Relationship

- One party (the Franchisor) grants the other party (the Franchisee) the right to offer or sell goods or services;
- Using the franchisor's brand identification, trade name or advertising;
- The franchisor either imposes significant controls over or offers significant assistance to the franchisee in respect to the operation of a business; and
- The franchisee makes payments to the franchisor in exchange for the right to enter into or maintain the relationship .

# Franchise Systems

There are two main types of franchise systems:

- *Product Distribution*

- The franchisor sells the franchisee products on an exclusive or semi –exclusive basis in a particular area
- The franchisor licenses its trademark and logo to the franchisee
- Generally, franchisees have more flexibility in the manner in which they conduct their business
- Examples: soft drinks (Pepsi); automobiles (Ford); gasoline (Exxon)

- *Business Format*

- The franchisee not only uses the franchisor’s product and/or services and trademark, but also the complete method for conducting the business
- The method for conducting the business is usually contained in a detailed operating manual that must be followed
- Examples: fast food (Wendy’s); convenience store (7-Eleven); Real Estate (Century 21).

# Franchise Systems

It has been estimated that franchised businesses account for 1/3 of all retail sales nationwide. Over 80 industries use franchising to expand their business. Below are the industries in which some of the most popular franchising opportunities can be found:

- Fast Food
- Retail
- Service
- Automotive
- Restaurants
- Maintenance
- Building and Construction
- Retail- Food
- Business Services
- Lodging

# Types of Franchise Arrangements

- Single Unit
  - The franchisee and franchisor enter into an agreement giving the franchisee the right to own and operate a single unit for a term
  - Most common type of franchise
- Multiple Unit
  - The franchisee and franchisor enter into an agreement giving the franchisee the right to own and operate multiple units for a term
    - Area Development Franchise – franchisee has the right to operate multiple units in a given area during a specific timeframe
    - Master Franchise – franchisee has the right to operate multiple units in a defined area and has the right to sell franchises to others within its designated area



# Payments to Franchisor

- The **franchise fee** is the initial amount the franchisee pays the franchisor to cover the franchisor's costs for locating, screening, negotiating with and training the franchisee
  - Fees may range from \$10,000 to over \$100,000 depending on the franchisor
  - Does not include start-up costs which may range from \$20,000 to \$1 million
- The **royalty** is a regular payment made to the franchisor based on a percentage of the franchisee's gross sales
- The franchisor may also charge the franchisee **other fees** for additional training or for transfers or renewals of the franchise arrangement

# Services Provided by Franchisor

- Varies by franchisor, but generally the franchisor will provide the following:
  - An operations manual addressing every aspect of conducting the business
  - A complete training program with advanced training and updates
  - Research and development for new products and services
  - Professionally designed local, regional and national advertising and marketing programs
  - Ongoing supervision and management support

# Franchising vs. Entrepreneurship

- Pros

- Can go into business for yourself but not by yourself
- Have an established product or service which already has widespread recognition
- Increases chances for success because you are using proven models for running a business
- Receive marketing support through regional and national marketing campaigns
- Greater ability to purchase supplies at discounted rates

- Cons

- Less flexibility in the way you run your business
- Must pay an initial franchise fee and ongoing royalties and advertising fees
- May be restricted in your ability to expand your business
- Actions of franchisor or other franchisees may negatively impact your business
- Franchisor may decide not to renew franchise agreement

# Franchising vs. Entrepreneurship

- Owning a franchise is owning a business – potential franchisees face many of the same issues and challenges as entrepreneurs
  - Should develop business plan
  - Form a business entity
  - Identify and consult with financial and legal advisors
  - In addition to the franchise fee, must determine other start-up costs (e.g. purchase or lease of business site)
  - Must identify assets to use for start-up costs or find sources for financing
  - Hire and train employees

# Legal Requirements

- Franchises are regulated by federal and state laws. Both the federal government and 15 states have laws, rules and/or regulations requiring franchisors to prepare and disseminate to prospective franchisees a disclosure document containing material information about the franchisor and franchised business.

# Legal Requirements – Federal Law

- The Federal Trade Commission (FTC) has adopted a Franchise Rule that requires franchisors to provide prospective franchisees with a disclosure document (the Franchise Disclosure Document or “FDD”) and copies of the forms of all franchise agreements and financing documents and the franchisor’s financial statements at least 14 days prior to the execution of a franchise agreement or the payment of any consideration by the franchisee.

# Legal Requirements – FDD

- Among other things, the FDD must disclose the following information about the franchisor and its business:
  - Business information about the franchisor and its affiliates
  - Information regarding the business experience of directors and officers within the last 5 years
  - Litigation, including any actions brought against franchisees
  - 10-year bankruptcy history of franchisor and its affiliates
  - Fees and estimated initial investment costs
  - Obligations of franchisees and franchisors in the system
  - Financing arrangements
  - Trademarks and other intellectual property
  - The availability of financial performance information
  - List of names of existing franchisees
  - Financial statements
  - Agreements related to the offering of the franchise

# Legal Requirements – FDD

- The FDD must be updated annually within 120 days after the end of the franchisor's fiscal year
- The FDD should also be amended for material changes (e.g. litigation, financial decline, program changes, etc.)



# Legal Requirements - State Law

- Some states, including NY, have registration and disclosure laws which provide that, unless there is an exemption, the franchisor may not offer or sell a franchise unless a prospectus has been filed with and approved by the appropriate state agency; failure to register in such a state means that the franchise may not legally be sold in that state.
  - As with federal law, state laws generally require a franchise to prepare and file an amendment to its disclosure if there is a material change
  - Franchisors may use their FDD, with certain modifications, to meet state registration/disclosure requirements
- These laws are intended to prohibit fraud and misrepresentation in the offering of franchises. The state agencies do not provide an opinion on the merits of the franchise offering.
- In many states that have registration/disclosure laws a franchisee may sue for damages if fraud is involved in the sale of a franchise.

# Legal Requirements – State Law

- 19 states have franchise relationship laws which govern when a franchisor may terminate a franchise relationship or refuse to renew a franchise
- They may also address other aspects of the franchise relationship such as discriminatory treatment, market protection and franchisee associations
- The provisions of these laws can supersede contradictory provisions in the franchise agreement

# The Franchise Agreement

- The Franchise Agreement is the primary document that governs the relationship between the franchisor and franchisee
- The Franchise Agreement should include such key provisions as:
  - Term, including rights to terminate the relationship
  - Territorial rights
  - Fees
  - Rights and obligations of each party, including support services to be provided to the franchisee
  - Transfer Rights
- Even though the franchisor has a standard franchise agreement which should be provided with the FDD, some of the terms are still negotiable
  - If the franchisor makes a unilateral change to the agreement, the parties must wait 7 calendar days before execution

# Making the Decision

- If you are interested in purchasing a franchise there are a few steps to take:
  - Research the different franchises that are available in your area and that meet your investment target
  - Select the most appropriate franchise based on your interests, finances, etc.
  - Make sure the franchise has a history of growth and solid future prospects
  - Decide whether you wish to invest in starting a new unit or purchase an existing unit, if available
  - If possible, visit the headquarters of the franchisor
  - Speak with current and former franchisees
  - Carefully review all materials provided by the franchisor, including the FDD and the franchise agreement with advisors

# Franchising an Existing Business

- Determine whether your business should be franchised
  - Is it profitable?
  - Can the method for operating your business be easily replicated and taught?
  - Do you have a registered trademark?
  - Are there available markets in which to expand your business?
  - Do you have the capability and infrastructure to run your business successfully and to provide training and operational support to franchisees?

# Franchising an Existing Business

- Assemble a team of professionals to assist you with the development of the franchise model
  - Franchise lawyer; accountant; franchise consultant
- Determine the level of services to be provided to franchisees
  - Initial services (e.g. training, opening assistance, construction and equipping, sourcing of goods)
  - Ongoing services (continuing training, field support, marketing and advertising)
- Create an operations manual
- Determine the pricing structure
- Register the business' trademark
- Have your legal advisor prepare the FDD, the franchise agreement and related agreements

# Getting Help

- The International Franchise Association (IFA) sponsors tradeshows and provides information about the franchising industry
- Attend trade shows and expositions
- Read relevant business publications
- Research directories and websites with information on franchising and franchising opportunities
- Franchise Brokers and Consultants
- Franchise Attorneys and Accountants