

## Fact Sheet

# Franchising – Some Initial Considerations for Potential Franchisors

### Is the business suitable for franchising?

It may seem obvious, but this is a key question from a commercial perspective. To sell a business model as a franchise, it must have value from the point-of-view of the franchisee. The franchisor must have a proven business format comprising recorded know-how and a package of intellectual property rights. The right to sell a particular product or line of products by itself is not a business format franchise. This may however be suited to operating as an agency or distributorship that may well prove to be a profitable business in its own right.

### Documenting know how

A business format franchise involves a system or template for the operation of all aspects of the business in question which, taken together with the name and trade mark of the business are distinctive and identifiable. Producing training materials and a detailed operational manual are therefore a normal part of preparing a business model for franchising. If the business does not already have developed materials of this sort, it should be expected that there will be a need to invest time and money in preparing them.

### IP audit

It will be obvious from the above that the name, trade marks and other intellectual property are a key part of what the franchisor is looking to sell. It is therefore recommended at an early stage that a prospective franchisor takes steps to confirm that he enjoys all necessary legal protection in respect of the intellectual property which forms the basis of the franchise. In the case of a franchise offered outwith the UK, this will involve considering whether appropriate protections have been secured in the target markets as well as within the UK (and if not, whether there are any obstacles to obtaining appropriate trade marks, etc).

### Pilot scheme

It is normal for franchisors to test their franchise model through an initial pilot scheme – this allows the franchise to build up a track record of profitability to attract additional franchisees and offers the franchisor the opportunity to refine the business model. However, it is unlikely that a franchisee will be prepared to pay much to be the guinea pig for a franchise model, so it should be borne in mind that a franchisor may not see much return from franchisees who are participating in a pilot scheme.

### Documentation

Before actively recruiting franchisees it is advisable to have good quality template franchise agreements available which have been prepared by lawyers familiar with the legal and commercial aspects of franchising. Where it is intended to recruit franchisees in foreign jurisdictions, it will be crucial to obtain legal advice on the laws within that territory applicable to the franchise on various matters, such as:- IP audit; preparing the franchise agreement; and in ensuring that the operational manual does not contain any advice or practice which is contrary to the laws of the territory in question.

### Contents of the Franchising Agreement

Here are some of the key issues to be addressed in the franchising agreement:-

- Is franchisee to be a limited company?
- Definition of the business
- Initial fee (consider tax implications).
- Continuing fee (consider calculation, mechanism for payment, tax).
- Advertising charge.
- Term of agreement.
- Rights to renew.
- Termination.
- Set out franchisor's obligations.
- Set out franchisee's obligations.
- Accounts.
- Insurance.
- Transfer.
- Territory.
- Exclusivity.
- Intellectual property – licensing of trade marks, and so on.
- Restrictions on competition.

## Advertising

When first getting started in setting up a franchise, a franchisor should expect to spend some time and effort in marketing the franchise to suitable franchisees. Legal controls on advertising (such as The Business Protection from Misleading Marketing Regulations 2008) make it advisable to obtain legal input on advertising materials to ensure the franchisor stays within the limits permitted by law.

## International Franchising

In addition to the issues mentioned above, seeking to franchise a business abroad raises additional considerations.

As well as the need for foreign legal input which we have mentioned above, it can often be the case when franchising overseas that it is better to do so in partnership with a third party, who acts as a master franchisor or developer of franchises within the territory, rather than the UK business itself acting directly as franchisor for a range of individual franchisees in a foreign jurisdiction.

Reasons for avoiding a direct franchise relationship with individual franchisees overseas include:-

- Substantial tax difficulties can arise in repatriating fees and other payments from franchisees to the franchisor.
- Franchisors will be expected to offer support and assistance to their franchisees, and in most cases this will be difficult to do when based in a different country.
- Franchisor may lack knowledge and information regarding the target country.
- It can be difficult for the franchisor to monitor compliance with the franchise agreement and operations manual from another country.

Alternatives to a direct franchise relationship include a master franchise, development, or joint venture agreement with a suitable partner in the target jurisdiction who can oversee development of the franchise within that territory, or establishing a branch or subsidiary within the target country to oversee development within the territory and overcome some of the tax difficulties associated with repatriation of fees paid directly from the franchisees.

## Conclusions

Franchising can be a cost effective and efficient means of expansion when applied to the right business model. It offers the opportunity to grow brand value with third party resources while still retaining a substantial degree of control. However, to achieve this result a potential franchisor needs to spend time and money carefully planning the structure and terms of his franchise at the outset.

### For further information please contact

Austin Flynn  
0131 247 1260  
austin.flynn@morton-fraser.com

### For further information please contact

Adrian Bell  
0131 247 1113  
adrian.bell@morton-fraser.com

### For further information please contact

Christian Hook  
0131 247 1333  
christian.hook@morton-fraser.com

## MORTON FRASER LLP

**Edinburgh** Quatermile Two, 2 Lister Square, Edinburgh EH3 9GL | DX: ED119 Tel: 0131 247 1000 Fax: 0131 247 1007  
**Glasgow** 183 St Vincent Street, Glasgow G2 5QD | DX: GW58 Tel: 0141 274 1100 Fax: 0141 274 1129  
**London** St Martin's House, 16 St Martin's le Grand, London EC1A 4EN | Tel: 020 7397 8621 Fax: 020 7397 8400

[www.morton-fraser.com](http://www.morton-fraser.com)

The information in this fact sheet is general - it is not meant as legal advice.

For questions about your situation, please get in touch with your solicitor at Morton Fraser, who will be happy to discuss how we can help you.

Morton Fraser LLP is authorised and regulated by the Financial Services Authority