What is franchising

Franchising is
simply a method of expansion and
distribution
Company’s use franchising

➢ To Achieve:

➢ Rapid Expansion

➢ Brand Recognition

➢ Consistency in the delivery of Brand Promise

A franchise is a form of a license

➢ Grants to franchisee the right to use marks

➢ Establishes Brand Standards

➢ Based on a financial relationship between the franchisor and franchisee
Franchising in the economy

- Over 100 different industries
- Over 900,000 US locations
- Over 4% of U.S. private-sector economy
- Indirectly over 11% of private-sector economy
- Over 8% of all private sector jobs
- Indirectly over 12% of private sector jobs
- Employs more people than durable goods manufacturing, financial activities and construction

Franchising statistics (US)

- Estimated 1,500 different franchisors from more than 120 industry sub-sets
- Over 900,000 establishments – franchisors and franchisees
- 11 Million jobs – 8.1% of all private sector jobs
- 3.3% of all small businesses
Franchising statistics (US)

- Over $880 billion (4.4%) of total U.S. private sector economy – direct impact
- Over $2.3 trillion (11.4%) of private sector economy – direct and indirect impact
- Franchised establishments grew by 18.5% during the period 2001 through 2005

Two types of franchises

- Product distribution franchising
- Business format franchising
Product distribution franchising

- Products are typically made by the franchisor for sale by franchisee
- Products usually require some preparation and post sale service.

Product distribution franchising

- Strong identification with brand
- Soft drinks, beer, bottling, automobiles and trucks, mobile homes, auto accessories, gasoline, farm equipment etc.
Business format franchising

- The system of delivery is more important in business format franchise than in a product distribution franchise

- Restaurants, hospitality, automotive aftermarket, travel, consumer products and services

The franchise relationship

- Based on a contract between the franchisor and the franchisee

- Detailed in the Franchise Disclosure Document, agreements, other licenses and operating manuals
The franchise relationship

- Partners
  - There is no fiduciary relationship between a franchisor and a franchisee
  - Franchisors generally work closely with their franchisees so there is often a feeling of a partnering relationship
  - The franchisor and the franchisee have their roles in the relationship and they are interdependent of each other

- Parent and Child
  - It sometimes feels that way
    - Early guidance, training and support
  - But - franchisees are not children
    - Franchisees are independent business people responsible for the day-to-day operation of their business
  - Franchising is a contractual relationship
The franchise relationship

- **Dictator**
  - For true entrepreneurs, the restrictions of being a franchisee can be overwhelming
  - Franchisees need to be “entrepreneur lite”
  - Franchisees voluntarily agree to follow a system but are responsible for the day-to-day operation of their business

Ownership Structures Used in Franchising
Single unit franchisee

- One location owned and operated by one franchisee under single unit agreement
- Location generally supervised by franchisee
- In their own right, franchisee is not a significant economic force
- Historically the most common relationship - Mom and Pop franchising

Single unit franchisee

- Weaknesses
  - Slower growth for system
  - More franchisees to work with
  - Franchisee may be less sophisticated
  - Financial condition of franchisee may cause less risk taking
  - Tends to increase cost of managing and servicing system
### Single unit franchisee

Franchisor

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Single Unit Franchisee

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### Developer/multi-unit franchisee

- Multiple locations owned by one franchisee.
- Generally each location has a single unit agreement.
- Developer generally has the right and the obligation to develop locations
  - Fixed Number of units
  - Set time for development
  - Typically in a defined area
Developer/multi-unit franchisee

- Can have significant advantages - if done right
  - Lower per location cost of acquisition
  - Better controlled growth in markets
  - Fewer franchisees to work with
  - Franchisees are usually more sophisticated
  - Franchisees financial condition are generally stronger – able to make business decisions
- Can reduce cost to support each location
Master franchisee

- Master franchisee is granted the right and obligation to seek sub-franchisees
  - Fixed number of units
  - Set time for development
  - Typically in a defined area
- Master franchisee typically required to own and operate at least one location

Master franchisee

- Typically collect royalties and fees
- Fees are generally split between franchisor and master franchisee
- Typically provides services to “sub-franchisees”
  - Training
  - Site selection
  - Field support, etc.
- Has fallen into some disfavor domestically
- Is still frequently used internationally
**Master franchisee**

Master Franchise Agreement

Franchisor

Master Franchisee

Single of Multi-Unit “Sub” Franchises

**Area representative**

- Provides franchise sales and support based on a commission structure
- Fees typically are split between franchisor and area representative
- Area representative may be responsible for
  - Site development
  - Opening and continuing assistance
  - Training and other local management duties
- Area Representative typically owns a franchise
**Area representative**

Franchisor

Area Representative Agreement

Area Representative

Solicits and supports franchisees

No Contractual Relationship

Single or Multi-Unit Franchises

**Conversion or experienced**

- Nonaffiliated operator converts to franchisor’s brand
- Terms of relationship may differ from greenfield franchises:
  - Fees
  - Training
  - Location
- Conversion often not complete – initially
- Can create some difficulties in consistency
Conversion or experienced

- Benefits for franchisee by converting:
  - Improved brand identity and protection against competitors
  - Economies of scale – purchases

- Benefits for franchisor:
  - Useful in consolidating market
  - Useful in real-estate constrained market
  - National accounts servicing

Non-traditional/mass gathering

- Franchisee may be a company that holds the rights to mass gathering locations
- May have terms that are different than traditional franchise offered to other franchisees
- Types of mass gathering locations
  - Airports, train stations, hospitals, college campuses, convenience stores, sports stadiums, ballparks, food courts, portable kiosks in parks, etc
- Traffic generated by high traffic locations with captured audience
Dual branding

- Two or more franchise concepts operate in one location
- Reasons for using
  - May utilize labor more efficiently
  - May improve return on real estate
  - May expand a location’s day part
  - Allows for shared common space

Retrofranchising

- Company owned locations sold to franchisees
- Popular reorganization and expansion strategy
  - Useful in reshuffling inventory of owned operations
  - Can be used to incentivize critical mass by franchisee
- Franchisor obtains capital from the sale
  - Proceeds used for debt reduction or other uses
Retrofranchising

- Eliminate local operations and personnel
- Reduces field management, home office administration and finance
- Continues existing distribution system
- Passive revenue (franchise fee, royalty, etc.)
- Not to be confused with churning

Alternative distribution strategies

- Company owned operations
- Joint ventures
- Cooperatives
- Licensing
  - Distributorships/Dealerships
- Telemarketing
Strategic Advice & Guidance

Based on Real World Experience

Why do companies franchise

Advantages for franchisors

- Control
  - The franchisor does not control the day-to-day management of the franchisee’s location
  - Franchisor sets brand standards
    - Products and services
    - Consumer brand management/promise
    - Marketing
    - Less than company owned operations - generally greater than independent dealers
Advantages for franchisors

- Unit investment and operating costs are transferred to franchisee
- Accelerates expansion
- No contingent liability on expansion capital
- No contingent liability on real estate
- No equity dilution

Advantages for franchisors

- Market penetration
  - Increased brand recognition as locations open
  - Enables penetration of smaller markets
  - Accelerates market dominance over local competitors
  - Improves location availability from landlords
  - As system expands value of brand, at the franchisor and franchisee level increases
Advantages for franchisors

- Collective buying power
  - Reduces costs for products, equipment, etc because of system purchasing capacity
- Shared resources
  - Warehouses, production and distribution
  - Brand marketing though system marketing fund

Advantages for franchisors

- Franchisee manages the day-to-day activities of their local business to system standards
- Franchisee responsible to execute to brand standards
- Franchisee manages labor, etc.
- Reduces company per unit cost of support
- Franchisees harder to unionize
- Franchisee liable for local operations – substantially reduces risk of vicarious liability
Advantages for franchisors

- Franchisee motivated to succeed
- Long term view of customer service
- Motivated to work longer hours
- Able to react quicker to local opportunities
- Knowledgeable about local markets
- Source of new product and service ideas
- Franchisee at risk for unit performance

Advantages for franchisors

- Revenue
  - Franchise fee upon signing agreement
  - Development fee from multi-unit developers
  - Continuing royalties typically based on gross sales
  - Contributes to advertising and marketing
  - Additional revenue opportunities
  - Reduced costs because of purchasing power
  - Franchisor does not share directly in unit losses
Advantages for franchisees

- Tested system of operations
- Brand standard product and services
- Franchisor’s brand (if established)
- Site selection and development assistance
- Training
- Headquarters and field support
- Support from other franchisees

Advantages for franchisees

- Reduced start up costs
- Reduced costs of goods
- Marketing assistance
- National accounts
- As part of system better able to compete with local and national competitors
- May provide exit strategy
Disadvantages for franchisor

- Cost of franchise system development
  - Professional fees
  - Consulting
  - Legal
  - Accounting
  - Registration and filing fees
  - Preparation of financial performance representation
  - Enterprise costs - staff and overhead
  - Franchisee recruitment

Disadvantages for franchisor

- Control
  - Franchisees are independent business owners executing a licensed system
  - Franchisees are responsible for day-to-day management of their business
  - Inability/limitations on setting pricing
  - Reduces location selection flexibility
  - Changes in business direction may be limited due to agreements with franchisees
  - Authority over system is limited to rights and obligations included in franchise agreement
Disadvantages for franchisor

- Maintaining good franchisee relations
  - Time consuming
  - Often politicized
  - Diminishes management independence
- Substandard franchisee performance
- Long term relationship – contractual terms
- Difficulty in terminating relationship
- Potential litigation

Disadvantages for franchisor

- Fees
  - Generally can’t be changed during the term
  - Can be dependent on
    - Competition
    - Anticipated and realistic growth projection for system
  - Cost of services offered to franchisees
  - Return on investment for franchisee and franchisor
Disadvantages for franchisees

- Loss of independence – localization of business
- Over-dependence on franchisor
- Performance of other franchisees
- Unrealistic expectations
- Territorial restrictions
- Risk of termination
- Restrictions on transfers to buyers
- Ability to continue and terms of successor agreements
- Continuing costs of being in system
Franchisability

Every business can be franchised, but
Not every business should be franchised

Prototype

Having a great idea is not enough
The franchisor should have profitably operated the business being franchised
Better yet, they should have done it more than once
Prototype

- The business should be able to define
- Criteria for locations
- Location layout – interior decor, exterior design, signage, etc
- Construction and development costs
- Seasonality and competition
- Brand personality
- Marketing
- Pricing strategy and operating costs
- Training
- Supply chain, etc, etc, etc, etc, etc, etc, etc.

Profitable prototype

- The business - even after franchise fees and debt service is profitable in a reasonable period of time
- The business can breakeven and become cash positive in a reasonable period of time
- Return on investment will be acceptable for each class of franchise being offered
Proven product or service

- The business is based on a well-established consumer demand
- The business can distinguish itself from the competition.
- The business has a high return customer base
- The company has ownership of its trade and service marks
- Recognizable brand

Proven product or service

- Types of businesses that generally lend themselves to franchising
  - sale at retail of goods and services
  - restaurants (most)
  - margins that allow for fees and leave adequate return on investment
  - lower regulations
  - stable market
  - low technology
Operating systems

- The business:
  - Is based on an organized concept
  - Can be systematized and codified in manuals and training programs
  - Is simple to operate
  - Can be consistently executed
  - Has been in operation for a sufficient time to project its future
  - If in a fragmented industry is a plus

Desire to expand rapidly

- The company has:
  - Realistic expansion goals
  - Can financially support growth and operations through break even
  - Has sufficient management band-width
  - Can support locations in multiple markets?
Teachable

- Franchisees:
  - Can be taught to manage the business in a reasonable period of time
  - Will be able to manage the day-to-day operation of the business to brand standards after training
  - Will be able to recruit sufficient staff with the education and skills required

Return on investment

- The cash investment is reasonable and affordable for the franchisee profile
- The investment is financeable
- Does not have serious cash flow deficiencies or cash calls that create barriers
- Will meet the ROI goals of the anticipated classes of franchisees
Franchisor operations

- The franchisor can provide
  - Training
  - Headquarters and field support
  - Competent advice to franchisees
  - Product and service enhancements
  - Evolve the business to meet competition over time

Marketable

- Someone - besides Mom and Dad – has requested a franchise
- There is sufficient number of potential franchisees
  - That meet the profile
  - Who have the capital
  - Who are likely to invest in the franchise
- The concept will support fees necessary to provide required franchisor services
The five realities

One: Every company that desires to expand by franchising should not necessarily become a franchisor.
The five realities

**Two:** Each company is unique, and fungible development or legal strategies rarely work

The five realities

**Three:** Franchising is governed by laws and regulations, but it is first a method of conducting business.
The five realities

**Four:** Business decisions should direct the structure and relationships of the franchise system.

The five realities

**Five:** The legal documents need to be well drafted and clearly convey the determinations made in developing the business system within the rules, regulations and case law governing franchising.
Strategic design components

- Operational
- Training
- Marketing
- Financial
- Legal

Each element of a franchise system is interdependent on each other

The initial steps

- Franchisability
- Review of potential alternative expansion strategies
- Advantages and disadvantages for franchisor and franchisee
- Availability of human and financial resources
- Assemblage of required outside professionals
Industry analysis and background

- Every franchisor has two levels of competition
  - For the end-user consumer
  - For the potential franchisees

The franchisor’s operations

- Understand the existing operations
- Determine how the franchisee is supposed to operate
- Determine the support programs and organization needed to meet these requirements
Typical franchisor support

- Franchisee
- Brand Promise and System of Delivery
- Real Estate Selection and Store Build-Out Assistance
- Management and Staff Training
- Store Operations Requirements
- Planning and Allocation
- Merchandising and Store Logistics
- Financial Planning and Reporting
- Standards Enforcement

System operational requirements

- Define the services provided to franchisees
- Define the procedures to provide these services
- Define the initial personnel requirements
- Determine when additional staff is required
- Define the relationship and obligations of the franchisor and franchisee – by class
Compliance and Monitoring

- Ensures locations operate to brand standards
- Supports franchisee to improve performance
- Examines marketability of products and services
- Reviews financial and other reporting
- The type and depth of compliance and monitoring depends on:
  - the amount of control required/desired
  - the areas which need to be controlled
  - the rights and obligations of the franchisee to manage the day-to-day affairs of franchise

Areas of monitoring may include:
- Site approval development
- Financial performance
- Operational standards
- Product and service quality
- Supply chain
- Marketing and advertising
- Pricing strategies
Compliance and Monitoring

- Areas of compliance and monitoring will not include
  - Human resources including pay scale, hiring and firing policies, benefits, etc.
  - Selection of outside contractors including but not limited to tradesman, lawyers, accountants, etc.
  - Banking and finance
  - Other areas of the franchisee’s day-to-day management responsibilities for their business

Field Support

- Field support should be organized and visits should be structured
- Field staff should be experienced, trained, disciplined and supported
- Field staff should
  - Ensure system compliance
  - Consult to improve unit performance.
  - Promote a sense of unity and belonging and demonstrate brand culture throughout system
Manuals

- The policies and procedures manual is the blueprint of the system - defining its shape and structure
- It is a tool for marketing a franchise
- It should be complete and graphically appealing
- It should be understandable by each reader
- It is frequently electronic and searchable

Manuals

- The manual should
  - Segment the operations of the business into an organized, logical set of guidelines and procedures
  - Reflect the franchisor’s culture
  - Reflect the requirements of the legal documents
  - Be an element of the training program
  - Support the necessary monitoring mechanisms
Manuals

- A manual library for a franchisor and its franchisees can be printed or online and include:
  - Unit operations manual
  - Real estate selection and development
  - Start-up
  - Marketing and advertising
  - Field services
  - Headquarters
  - Multi-unit operators, Area representatives, Master franchisee, among others

Training

- Your franchisees, headquarters and field staff must be prepared to meet the challenge of operating within the system
- Define the scope and curriculum for the system's training programs
  - Headquarters and field support organization
  - Franchisee, management and staff initial and continual training
  - Multi-unit and Master franchisee operations
  - Company owned operations
Training

- Appropriate for each level of personnel
- Determine approach including length, location and instructors
- Identify and train to the skills, abilities, and knowledge required for the personnel
- Determine training methods: classroom, web-based, OJT, video/DVD, blended
- Develop testing and requirements for passing

Franchise development

- Prescribe and prioritize the expansion goals
- Identify the profiles of franchisees
- Define the markets, critical mass and mix of strategies appropriate for the system
- Determine the franchisee recruitment and selection process
- Evaluation the use of a retrofranchising strategy
- Define territorial rights, if any, to be granted
The franchisee profile

- Serves as a set of guidelines to select candidates most suitable for the franchise
- Is the foundation for the development of the franchisee recruitment and selection program
- Determines where and how you need to market your franchise
- Determines the budget you need to meet your growth requirements

Search/Screen/Approval/Close

- **Search:** Appropriate sources for recruiting franchisees that best fit profile
- **Screen:** Methodology for evaluating franchisees (financial, personal, etc.)
- **Approval:** Procedures for approving franchisees - initial assessments, deposit agreements, verification procedures, committee approval procedures, etc.
- **Close:** Administrative, compliance and signing procedures.
Market analysis and strategy

- Analysis of the franchise relative to the competition
- Positioning of the concept against the competition
- Determination of the most effective means of market entry given the profile of your franchisee, real estate requirements, concept, etc.

Positioning

- Strengths and weakness of products and service at the retail level
- Capabilities of system to deliver brand personality to consumers
- Operating environment including management and labor availability
- Financial resources of franchisees
- Other elements i.e. real estate, etc.

Positioning gives you a basis to build your growth approach
Market entry

- Review the strengths and weaknesses of the alternative methods of expansion available
- Determine the best mix of strategies for the company and by market if appropriate
- Segment markets into the targeted mix – i.e. company – franchised – mass gathering
- Prioritize according to overall strategy

Financial Modeling

- Necessary to
  - Project start up costs and capital required
  - Determine break even, cash flow, return on investment
  - Establish fees – franchise fee, royalty, ala-carte charges, multi-unit fee structure, advertising, etc.
- Should be done for franchisor and each class of franchisee
Financial Modeling

- Unit economics
- Franchisor economics
- Projected rate of growth for the franchise system
- Projected rate of growth for company-owned system
- “Cost out” of each material operational, training, legal and marketing obligation included in legal documents
- Define what needs to be measured and reported
- Assess and determine exit strategies

Business overlay

- Necessary to build strategic plan and document in manuals, training programs, marketing strategies, franchise disclosure documents and legal agreements
Business overlay

- Directs legal counsel regarding the business decisions reached by management
- Shapes the franchisor - franchisee relationship
- Defines the rights and obligations, policies, procedures, monitoring and contractually obligated support services

Business overlay

- Threshold Analysis
- Gap Analysis
- Competitive Analysis
- Assessment of each available route to market
- Description of the risks and advantages of the expansion models selected
- Definition of the franchise business and offering
- Management of the franchisor
- Bankruptcy and litigation history
- Initial investment for franchisor and franchisee
- Initial fees and structure
- Royalty and other ongoing fees
- Advertising fees
- Ala-carte fees
Business overlay

- Financial proforma for franchisor and franchisees by class
- Duration of franchise
- Successor rights
- Termination rights
- Resale and assignment rights
- Real estate selection and development
- Lease/sublease policies
- Trade marks and service marks
- Trade secrets
- Financial, other audit and inspection rights

Business overlay

- Brand standards for operations
- Unit management and staffing
- Obligations of franchisee or designee to operate business
- Franchisee's reporting requirements
- Supply chain
- Restrictions on sources, suppliers and supplies
- Approval process for new products, services and suppliers
- Performance criteria
- Initial and ongoing training
- Pre-opening obligations
- Continuing obligations
- Financing programs
Business overlay

- Marketing and advertising fees, limitations and requirements
- Grand opening support and advertising
- Process to approve franchisee developed advertising
- Franchisee and franchisor rights and obligations
- In-term and post term covenants
- Public figure determination
- Evaluation of including a financial performance representation (FPR)
- Developed FPR
- Overview of unique industry related laws
- Planning and allocation

Business overlay

- Visual merchandising
- Plan-o-gram requirements
- POS and IT
- Web site development
- Multi-unit organizational requirements
- Pricing strategies
- Brand fund and usage
- Packaging issues
- Consumer feedback
- Franchisee recruitment
- Franchise program development
- Brochures and content
- Franchise recruitment coordination and documentation
- Chain management – low performing unit assistance
- Other legal issues, documentation, etc.
Implementation

- Development of
  - Legal documents
  - Manual library
  - Training programs
  - Website
  - Franchisee recruitment collateral
  - Franchisee support requirements
  - Forms and procedures
  - All the rest of it

Investment Required

- Franchise Consulting
- Repairing the Gaps
- Manual library
- Training Program
- Franchise Recruitment Material
- Website
- Development of the required infrastructure
Investment Required

- Trademark Registration
- Franchise disclosure, legal agreements and other legal documents
- Regulatory costs
- Financial audit
- Sales and compliance training
- Average time to complete franchise development - Four to Five Months

Common franchise terms

- **Acknowledgement of Receipt** – Item 23 of the Franchise Disclosure Document (FDD) that is signed by the prospective franchisee and provided to the franchisor (in hard copy or electronically signed) as proof of the date the FDD was received by the prospect.
- **Advertising Fee** - An amount paid by the franchisee to the franchisor as a contribution to the franchise system’s advertising fund. The fund is typically established to pay for the creation and placement of advertising and used to offset the franchisors administrative costs relating to “retail”/“brand” advertising. Payments are typically calculated as a percentage of gross sales.
- **Agent** - A party that has implied or express (oral or written) authority to act on the behalf of another.
- **Approved Advertising Materials** – Materials provided by franchisor for the franchisee’s use in their local market or materials created by the franchisee which the franchisor has approved for use.
Common franchise terms

- **Approved Products** – Specified products which a franchisee must buy for use in their business. Franchisor may also specify an authorized supplier (see authorized supplier definition below). Generally established to control the quality of the products used or sold by the franchisee in conducting their business.
- **Approved Site** – A location that the franchisor determines will satisfactorily meet its criteria. Site approval by franchisor is generally not an indication of the sales potential or success of the location.
- **Arbitration** – A method of resolving disputes.
- **Area Franchise** - a franchise relationship which allows the franchisee to open multiple locations, usually in a defined territory on a pre-agreed time line. Area franchisees usually pay an area fee for the rights granted by the franchisor.
- **Authorized/Designated Supplier** - A supplier of products and/or services used in the operation of the franchise who has been approved by the franchisor to sell to franchisees. May be the franchisor or an affiliate company.

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Common franchise terms

- **Broker** - an outside salesman or firm which undertakes for a fee or commission the sale of franchises for a franchisor. Some brokers like to call themselves franchise consultants but this is a misnomer. See franchise consultant.
- **Business Format Franchising (BFF)** - A franchise occurs when a business (the franchisor) licenses its trade name (the brand) and its operating methods (its system of doing business) to a person or group (the franchisee) who agrees to operate according to the terms of a contract (the franchise agreement). The franchisor provides the franchisee with support and, in some cases, exercises some control over the way the franchisee operates under the brand. In exchange, the franchisee usually pays the franchisor an initial fee (called a franchise fee) and a continuing fee (known as a royalty) for the use of the trade name and operating methods. BFF describes the system of delivery, not the specific product or service associated with the delivery as in Product or Trademark Franchising.
- **Business Plan** – A planning document that details the objectives for the business and establishes processes and measures for meeting those objectives.
Common franchise terms

- **Capital Required** – The initial investment or required amount of investment necessary to conduct the business.
- **Certification** – Program by which franchisor or its franchisee may test and attest to the ability of an employee to perform certain job functions within the franchisee’s business to the franchisor’s standards. Certification can generally be revoked if the employee fails to maintain standards in performing the job function.
- **Churning** – A failing location acquired by the franchisor and resold to a franchisee even though the franchisor felt that the location had a high chance of failure regardless of ownership. While churning is not a common occurrence in franchising today, it does occur and sometimes a single location may be churned several times. Churning is not the same as retrofranchising. (See retrofranchising).
- **Company Owned Location** - Locations, owned and operated by the franchisor, usually identical in appearance and operations, to those of the systems franchises.

Common franchise terms

- **Copyright** - The right to use and license others to use intellectual property such as system manuals or other published materials.
- **Continuous Training** - Training provided by franchisors to its franchisees, unit management and staff, subsequent to the initial training provided.
- **Conversion Franchising** - The conversion of an existing business within the franchisors industry into the franchise system. Sometimes includes experienced operators without operating locations.
- **Culture of Compliance** – Company culture whereby franchisees and staff do what is right for the system based on a feeling or knowledge that it is the right thing to do within the company philosophy rather than because it is in the agreement or someone is watching.
- **Days** – Unless otherwise stated, days generally refer to calendar days.
- **Day-to-Day Management** - As an independent owner the franchisee is obligated to manage the day-to-day affairs of their business to meet the franchisor’s brand standards.
Common franchise terms

- **Default** - The failure of either party to meet the terms of the agreement. In franchising certain defaults are enumerated and some can be cured in a defined period while others may not be curable.
- **Design** - The trade dress used by the franchise system for the franchise locations including layout, color scheme, signage, logo etc.
- **Disclosure Document** - Also known as the Franchise Disclosure Document (FDD) (formerly known as the Uniform Franchise Offering Circular (UFOC)). The format of the FDD is specified by The FTC and NASAA (Federal and State regulators) and provides information about the franchisor, the obligations of the franchisor and the franchise, fees, start up costs, and other required information about the franchise system. Includes a listing of current and former franchisees. In addition to the disclosure portion of the FDD, the document will contain the franchise and other agreements and exhibits.
- **Distributorships** - The right granted by a manufacturer to sell their products.

Common franchise terms

- **Exclusive (protected) Territory** - A geographic area which provides the franchisee with certain rights, which may include exclusive operation. Franchisor’s may include carve out provisions within an exclusive territory which define an excluded type of location (malls, airports, stadiums, arenas, supermarkets, hospitals, etc.)
- **Feasibility Study** - An examination of the potential of a company to franchise or of the potential success of a unit within a specific market or specific location.
- **Federal Trade Commission** - The FTC is the agency of the U.S. Government which regulates franchising under FTC Rule 436.
- **Field Representative** - Typically an employee of the franchisor responsible for ensuring compliance by the franchisee with system standards. Also responsible for providing assistance to franchisees in the operation of their businesses. May be a commissioned Area Representative.
- **Financial Performance Representation** - Formerly known as an Earnings Claim an FPR is the Item 19 representation of unit performance by a franchisor.
Common franchise terms

- **Footprint** - Layout of a location including placement of all furniture, fixture and equipment.
- **Franchise** - A relationship, as defined by the FTC and various states which typically includes three basic elements: (1) the granting of the right to use the systems mark, (2) substantial assistance or control provided by the franchisor to the franchisee, (3) the payment of a fee (in excess of $500 during a period of time six months before or six months following the commencement of the relationship.
- **Franchise Agreement** - the agreement between the franchisor and franchisee which specifies the obligations of each party to the other during and following the franchise relationship.
- **Franchise Attorney** - A lawyer specializing in, or with significant knowledge of the laws, regulations and customs governing franchising.
- **Franchise Consultant** - a business specialist with significant knowledge of the design, development and operation of franchising and the underlying franchise relationship. Not to be confused with a Broker which is a sales agent for the franchisor. (See definition of Broker above)
- **Franchise Fee** - the initial fee paid by the franchisee to the franchisor, usually upon signing the franchise agreement, as consideration for joining the system. Is typically a flat payment as opposed to a percentage royalty and is used to offset franchisor’s franchisee start up costs, marketing for franchisee’s and other corporate expenses.
- **Franchisee** - the person or company who is granted the rights (license) to do business under the trademark and trade name by the franchisor.
- **Franchisee in Good Standing** - Franchisee is operating their location and business in material compliance with franchisor’s operating standards and is current with all payments owed to franchisor and key suppliers.
- **Franchising** - a indirect method of distribution; in other words a method of growth.
- **Franchisor** - a person or company which grants the license to a third party for the conducting of a business under their marks.
Common franchise terms

- **Gray Marketing** – Franchisee purchases under franchisor's negotiated agreements and uses product or merchandise in another business or sells products or merchandise to another company.

- **Gross Sales** – When used in franchising, generally the total sales of the business, before the collection of any sales taxes and after specified deductions. Generally used as the basis for percentage royalty calculations.

- **Initial Investment** - the total estimated cost for establishing the business including: franchise fee, initial fixed assets and leasehold improvements, inventory, deposits, other fees and costs and the working capital required during the initial start up period (three months).

- **International Franchise Association** - The industry trade association representing franchising. The IFA is based in Washington, DC. www.franchise.org.

- **Internet Sales** – Any sale initiated and completed on the world wide web.

- **Inquiry** – Anyone requesting information about the franchise opportunity whether via the web, by telephone, by fax or other methods.

- **Key Supplier or Vendor** – Supplier with whom franchisor has negotiated pricing or product availability and whose products or services are an integral part of the franchise system.

- **Lead** – An inquiry that is prequalified after the initial interview with a member of the franchisor’s development staff as meeting the minimum criteria to become a franchisee and is invited to submit a franchise application.

- **Location** - the site of the franchised or company owned operation.

- **Manuals** - the reference literature, published by the franchisor which specifies the method of operating the business under the mark. The operations manual enables the franchisor to alter and evolve the business.

- **Market Introduction Program** – Marketing, advertising and public relations activities used to launch the franchisee’s location.

- **Master Franchisee** - a franchise relationship which is granted for the development of a specified area and which allows the master franchisee to subfranchise to other franchisees within the specified territory.
Common franchise terms

- **Multi Unit Developer** – A franchisee who agrees to open two or more locations generally in a defined market over an agreed upon period of time.
- **Operating Principal** – Franchises owned by other than an individual that appoints a single individual authorized to make decisions on behalf of the franchisee. This person is the operating principal and is usually the person with whom the franchisor consults in regarding the operation and conduct of the franchise.
- **Product and Trade name Franchising** - the licensing of a franchisee/dealer to sell or distribute a specific product using the franchisors trademark, trade name and logo. (Automobile dealerships, Truck dealerships, Farm equipment, Mobile homes, Gasoline service stations, Automobile accessories, Soda, Beer, Bottling. Describes the specific product or service associated with the delivery not the system of delivery as is Business Format Franchising.
- **Protected or Exclusive Territory** – Protection or exclusivity granted to franchisee by franchisor against the opening of company, franchisee or other locations within the territory assigned to a franchisee.

Common franchise terms

- **Prospect** – A person who has expressed interest in continuing the approval process by completing and submitting the franchise application and whose application has been preliminarily approved by the approval committee or the development director.
- **Quality Standards** - The standards specified by the franchisor for the operation of the business. Quality standards are specified in the manuals for the benefit of the franchise system and its franchisees.
- **Registration** - A requirement to submit the franchisors disclosure document prior to the approval to offer franchises within some states. There is no requirement to register a franchise at the Federal level.
- **Registration states** – The various states that require franchisors to submit their FDD for approval prior to offering franchises. The registration states are members of NASAA.
- **Retrofranchising or refranchising** – Retrofranchising is not the same as churning. Existing locations that may or may not have ever been franchised, currently operated by the franchisor, offered for sale to prospects. Different than churning the franchisor has an expectation that the business will be successful.
Common franchise terms

- **Royalty fee** - Typically a percentage of gross sales paid by the franchisee to the franchisor on a regular basis. May also be a fixed or other fee basis.
- **Service Mark** - A mark used to identify the services of one company as distinguished from the services of another. Service Marks are afforded similar protection under the law.
- **Single Unit Franchisee** – Franchisee who owns and operates a single location.
- **Start-up Costs (Initial Investment)** – The initial investment that the franchisee will make in becoming a franchisee. It is also known as an Item 7 disclosure. Generally includes the franchise fee, the cost of fixed assets, leasehold improvements, inventory, deposits, other fees and costs and working capital required during the start-up period.
- **Successor agreement** – Franchisee’s ability to continue in the business for additional terms following a successful completion of their initial term.

Common franchise terms

- **Success** - As used in franchising, the absence of failure or closing of a location. Does not relate to unit sales or profitability.
- **System Brand Fund** – A fund established and managed by franchisor to which all franchised and usually all company-owned units contribute monies to be spent on promoting and protecting the franchisor’s brand. Frequently called an advertising fund.
- **Royalty fee** - Typically a percentage of gross sales paid by the franchisee to the franchisor on a regular basis. May also be a fixed or other fee basis.
- **Trademark** - The mark, name, and logo which identifies the franchisor and which is licensed by the franchisor for use by the franchisee.
- **Turn-key** - A term used to describe a location which is provided to a franchisee fully equipped and ready to operate.
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