

# FRANCHISING

**EEP 142**

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# Definitions



**Franchise:** Agreement or license between two parties which gives an individual or group the right to market a company's goods or services utilizing that company's trademark within a certain territory or location

**Franchisor:** Person who grants independent operators the right to distribute its products, techniques, and trademarks for a percentage of gross monthly sales and a royalty fee

**Franchisee:** Person who utilizes another person's business philosophy and takes advantage of that person's brand recognition, successful method of doing business, and proven marketing and distribution system.

**Franchise Agreement:** Agreement between franchisor and franchisee that states the term limit of usage, legal obligations, and duties.

# History of Franchising



**Middle Ages:** Versions of franchise relationships occurred in Europe and through their efficiency spread to the US.

**1850's:** Practice of modern franchising begins. Isaac M. Singer is credited for this occurrence.

**1933:** Franchise-based food service establishments occur.

**1935:** First modern restaurant franchise is established by Howard Johnson and Reginald Sprague.

**1950's:** Business format franchising, the dominant mode of franchising today, rises in popularity and dominance.

# Early vs. Modern Developments



- Franchisors used to collect royalties or fees on a product basis and not on the gross sales of the business operations of the franchisees
- Franchisors now collect royalties on the gross sales of these units and not on the profits

*Let independent operators use the same name, food, supplies, logo and even building design in exchange for a fee*



# Types of Franchises



- **SOCIAL FRANCHISES**
- **Ex: soap making, whole food retailing, aquarium maintenance, hotel operation**
  
- **EVENT FRANCHISING**
- **Ex: World Economic Forum, alter-globalist World Social Forum, Davos forum which has regional event franchisees in China, Latin America, etc.**

# Types of Franchises



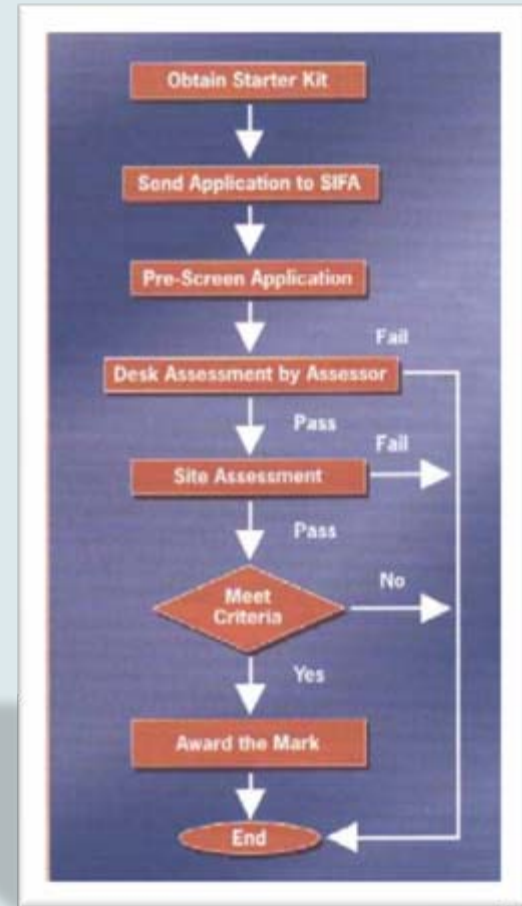
- **BUSINESS FORMAT FRANCHISING**
- Ex: quick service restaurants, automotive services, lodging, real estate agents, convenience stores and tax preparation services
  
- **PRODUCT & TRADE NAME FRANCHISING**
- Ex: automotive, petroleum and soft drink

# Qualities of Businesses that Can Effectively Franchise



- Good track record
- Unique concept
- Broad geographical appeal
- Easy and inexpensive to operate
- Easily duplicated

Source: Alon, Ilan (2005), *Service Franchising: A Global Perspective*, New York: Springer.



Source: <http://www.spring.gov>

# Buying a Franchise



## Advantages

- Proven idea
- Brand name/Trade mark
- Reputation
- Financial support
- Training/Manuals
- Network support
- Exclusive territory

## Disadvantages

- Initial cost
- Continuing royalties
- Reputation
- Franchisor closing
- Selling your franchise
- Restrictions/Control

Source: <http://www.businesslink.gov>

# Selling Franchises



## Advantages

- Ease of expansion
- Localizes legal issues
- Fewer operational costs



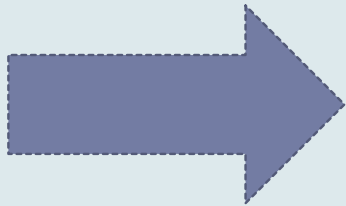
## Disadvantages

- Narrow pool of feasible franchisees
- Limited control of incompetent franchisees
- Legal fees and reputation damage from incompetent franchisees

# Impact of Franchising on Consumers



- Can expect similar products/services across the country or even the world
- Prices won't vary much
- More locations and accessibility



**NO SURPRISES**

# Problems of Franchising



- Legal disputes

- Relationship between Franchisor and Franchisees



# McDonald's

## Legal disputes



- **Defamation**

'the biggest corporate PR disaster in history'

- **Trademark and copyright**

(e.g. MacJoy=>Myjoy in the Philippines) threatening many foodservice businesses with legal action unless they drop the Mac from their trading name

- **Labor**

against the laborers to stop the group from using the “McDonald’s” name in their protests

- **Advertising**

- (e.g. French fries ad in the UK in 2003) fine line between misleading and out and out lies

- **Health and Safety**

(e.g. The McDonald's coffee case in US) third-degree burns after spilled hot coffee at one of the company's drive-thrus

# Subway

## Relationship between franchisors and franchisees



- **"The Worst Franchise in America"**

*"During the 1990s, Subway was involved in more legal disputes with franchisees than any other chain- more than Burger King, KFC, McDonald's, Pizza Hut, Taco Bell, and Wendy's combined."* -Fast Food Nation (Eric Schlosser, 2001)

- **Fred De Luca**

Cause a set of problems unmatched in the business, including unhappy franchisees, disputes with landlords, and run-ins with regulators.

- **Too many locations in one neighborhood**

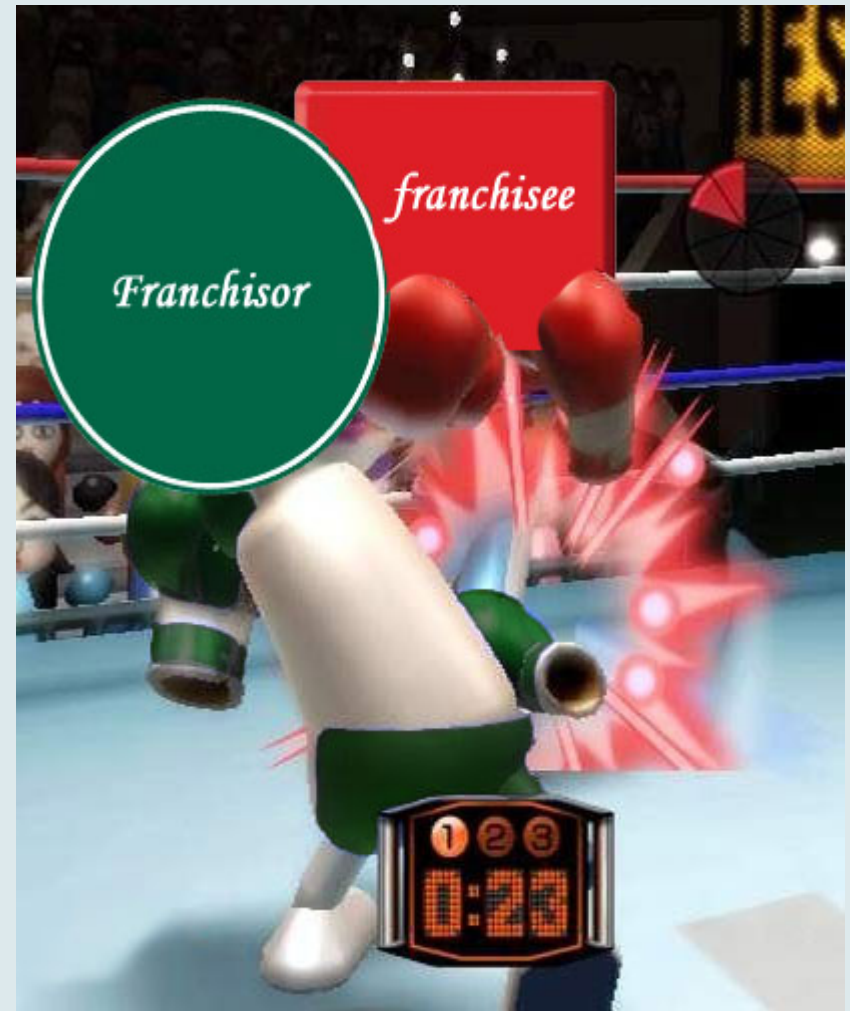
Many Subway franchisees insist bitterly that the company has defrauded and damaged them by opening too many franchises in their neighborhoods.

- **Relatively high royalty**

8% of gross sales, 3.5% advertising fee

# The Purpose of Franchise Rule

- To protect franchisees before investing by providing them with information essential to an assessment of the potential risks and benefits, to meaningful comparisons with other investments, and to further investigation of the franchise opportunity.



# Federal Trade Commission



- An independent agency of the United States government, established in 1914 by the Federal Trade Commission Act
- Enforcing a variety of federal antitrust and consumer protection laws.
- Franchisors are required by the FTC to provide a Uniform Franchise Offering Circular (UFOC) to disclose essential information to potential franchisees about their purchase



# The Franchise Rule



- **Requirement:** Franchisors must give **Uniform Franchise Offering Circular** to franchisees at least 10 business days before any contract is signed and before any money changes hands.
- **UFOC:** It is known as the Franchise Disclosure Document. It is a legal document that provides Information of a franchisor .  
ex) Identity and Business Experience of Key Persons, Bankruptcy, Initial Franchise Fee ,Other Fees and Expenses, Financial Statements ,etc

# The Franchise Rule Requirements



**General:** six different requirements in connection with the "advertising, offering, licensing, contracting, sale or other promotion" of a franchise in or affecting commerce:

- **1. Basic Disclosures:** franchisors need to provide investors a disclosure document.
- **2. Earnings Claims:** If a franchisor makes earnings claims, they must provide a reasonable basis to a potential investor in writing.
- **3. Advertised Claims:** The franchisor must disclose the number and percentage of existing franchisees who have achieved the claimed results.

# The Franchise Rule Requirements



- **4. Franchise Agreements:** The franchisor must give investors a copy of its standard-form franchise and related agreements.
- **5. Refunds:** The Rule requires franchisors to make refunds of deposits and initial payments according to any conditions on refund ability stated in the disclosure document.
- **6. Contradictory Claims:** Franchisors are free to provide investors with any materials they wish, However, it must not contradict information provided in the disclosure document.

# The Franchise Rule Overview



- **Basic Requirement:** Franchisors must provide written disclosures.
- **Disclosure Option:** Franchisors may make the required disclosures by following either the FTC Rule's disclosure format or the Uniform Franchise Offering Circular Guidelines prepared by state franchise law officials.
- **No Filing:** Disclosure only. Unlike state disclosure laws, no registration and filing
- **Remedies for the violation:** The Rule is a trade regulation rule with the full force and effect of federal law. The courts have held it may only be enforced by the FTC, not private parties. The FTC may seek injunctions, Asset Freezes, civil penalties and monetary redress for violations.

# Controversies in Franchising



- Franchisors take advantage of franchisees by illegally manipulating them to operate at unprofitable levels
- Franchises usually do not partake in promotions that another store might which leads to confusion amongst consumers
- Incompetency by either party can cause the brand to go down the drain

# Future of Franchising



- Growth of the franchising industry as firms can expand their businesses easily with the built network
- Increase in the number of franchisors due to the current economy

How is franchising related to EEP?

They just bought a  
franchise!!!!



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