

Dentons Franchise Advisory

Dentons franchise guide:

Seven steps to a successful franchise business





Introduction

The journey as a global franchisor or franchisee can be complex, but highly rewarding when undertaken properly with the right legal structures, systems, people and planning in place. Never compromise on any of these elements.

As leading advisers in franchise law, clients are always asking us to help them not only with legal advice, but also with their franchise strategy. So we created Dentons Franchise Advisory to help our clients beyond the law, leveraging the wealth of market data and insights at our fingertips.

Leveraging our experience from working with more than 400 franchise systems around the world, we have developed this toolkit to help both new and experienced franchisors understand how franchising can help their business. You will discover the key success factors in developing a robust franchise model as well as strategic planning insights to assist in the successful implementation of your franchise.

Dentons Franchise Advisory is here help and guide you every step of the way, so please feel free to reach out to us if we can be of assistance with any of the issues covered in this guide.



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Franchising in a nutshell

When franchising is correctly understood and applied, it is a highly sophisticated business tool.

Franchising is not confined to fast food. In the last 20 years franchising has become the structure of choice for international expansion for a large number of global brands.

Franchising works. To demonstrate this claim, you only need to look at McDonalds that reported more than US\$5 billion revenues in 2020. McDonald's uses a heavily franchised business model. In 2018, the company had 93% of total restaurants franchised. Although company-operated restaurants have higher revenues compared to franchised restaurants, they contribute less to the company's gross margins and net income. We can look at certain brands as a 'best in class' and assist you in developing your 'best in class'.





In a franchise, the franchisor licenses a complete business model to the franchisee. The franchisor provides branding and know-how in return for a royalty fee. Often the franchisor is also the sole supplier of certain key products or services, which it sells at an agreed margin. Franchising is thus a form of business by which the owner (franchisor) of a branded product or service obtains distribution through affiliated partners (franchisees). Franchising can be viewed as a low-risk alternative to a joint venture. A well-run franchise system creates a win-win partnership between franchisor and franchisee where each partner contributes its special skill set.

The franchisee operates the business on the basis of detailed guidelines, uniform quality standards and thorough training. The franchisor ensures compliance with its brand standards via regular brand audits. Franchising is not risk-free, but the risks can be controlled using an established quality control toolkit.

Benefits of franchising

There are important benefits to a business that elects to franchise. Primary benefits are the growth achieved by risk sharing and leveraging the resources of third parties, the franchisees.

Franchising is not a quick fix for a struggling business, quite the opposite. The underlying business case needs to be sound for franchising to succeed. The success of franchising is based on the "value proposition" whereby the franchisee is given access to a tried and tested profitable business format supported by bespoke training and back-up systems.

Benefits to franchisor

Asset light expansion

Low risk, low costs

High margin for strong brands

Fast Growth, scalability

Easy access to local talent



Benefits to franchisee

Access to brand name, brand image

Tried and tested store format

Minimised risk partnering with global brand

Access to an established business model

Benefit of brand reputation

Capital requirements will be lower because the franchisees provide the capital to grow their franchised rights.

Franchisor central marketing activity combined with effective local market activation will reach the target customer more effectively through local know-how and entrepreneurial flair and promotion initiatives. A franchisor can provide industry intelligence and insight and keeps the brand relevant and up to date, thus competitive.

Entrepreneurial franchisees are invariably more motivated, treating the franchise operations as their own business, usually leading to higher sales and profit levels. Franchisors gain access to local expertise and know-how provided by the franchisee, typically routed in the local community. Further franchisee innovation can contribute to new ideas for the business.

Speed of growth through an active and incentivized franchise network that can grow as fast as the franchisor can develop its infrastructure to recruit, train and support its franchisees. Multiple franchisees can develop in parallel, which isn't always possible in a non-franchised business. Provided the franchisor can recruit and train franchisees quickly the opening of new units can be accelerated to a much faster pace.

Interdependent leadership and responsibility enable a more hands off approach in day-to-day operations thus enabling speed of growth.

Perpetual earning through a royalty-based income stream that adds value to the franchisor's brand and importantly covers the day-to-day running costs of the franchisor.

A Leaner HQ. A franchisor needs fewer people to build a global business by enabling a franchise community to build a franchise network. A smaller, talented, experienced franchise leadership and business development team is an effective model. There is no need for HR administration to deal with holidays, sickness and payroll for shop floor staff, all this is handled locally by the franchisee with support from the franchisor in the form of systems and training where required.

Brand equity and market share is enabled much faster through the leveraging the assets and brand execution of franchisees efforts.

International growth is easier and faster through overseas entrepreneurs leveraging local know-how, cultural knowledge and local business intelligence. There are many successful global brands that have grown exponentially through franchising internationally.

Limited risk of capital outlay and asset light growth by partnering with others.

The 5 key ingredients of a successful franchise

Franchising is a win-win business model. It brings together the brand name and know-how of the franchisor and the local market knowledge and capital of the franchisee to enable both businesses to grow together domestically and internationally at a pace.

Fundamentally, franchising is simple. The five key ingredients of a successful franchise are straightforward. You need:

1.

A strong brand name and trade mark that is easily recognizable.

2.

A unique business model that sets the franchised business apart.

5.

Ease of Training. The system should be easy to teach assuming the franchisee is properly qualified.

4.

A well-developed quality control and know how transfer system.

3.

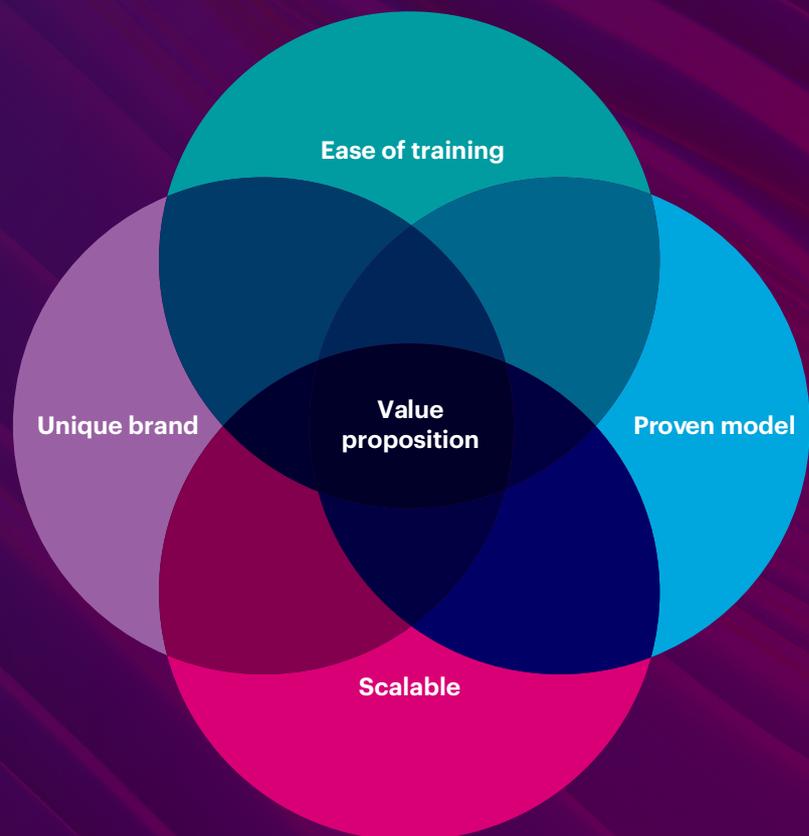
A strong value proposition that enables both franchisee and franchisor to make an attractive return on their investment.

If your business meets these requirements, it is likely that it can be franchised.

Franchising allows the sharing of risk and reward.

The franchisor establishes the brand's trademark or trade name and a business system and the franchisee provides the local market knowledge and capital to establish the franchised business on the ground. As such, a franchise relationship is a partnership between the franchisee and the franchisor. The franchisor provides to the franchisee a tried and tested business model. The franchisee pays franchise fee for the privilege of using the know-how and system developed by the franchisor.

The secret of successful franchising is to ensure that both parties understand and perform their role correctly.



What can be franchised?

Any business that meets the five key franchise criteria can potentially be franchised. If you have a unique product, offering or service and a strong brand name, it is worth exploring how it can be replicated through the entrepreneurship of a franchise. Franchising is a business model to enable a growth strategy. It is not an 'industry', and there is no defined 'rule book' per se. The principles of franchising have a very broad application but a successful franchise must have rigor in its planning, development, implementation and execution.

From retail to restaurants, hotels, domestic and industrial services, education, automobile dealerships and car rental. All of these have proven franchise models.

The list below shows key industries that have experienced significant momentum in the franchise category, and demonstrates how flexible a franchise growth strategy can be.





Repairs and
Installation
services



Accounting services,
will writing, tax



Printing services

Seven steps to a successful franchise business

Based on our work with best-in-class franchisors and franchisees around the world, we have identified seven key steps in launching a successful franchise business. These can take time, but investing time up front in a process of careful preparation and analysis will help you lay the foundations of a successful model, and avoid potential pitfalls down the line.

- **1. Risk benefit exercise**
analyse the risks and benefits of franchising fit your corporate profile and strategy
- **2. Financial Modelling**
establish if the business generates sufficient profit to allow it to be franchised successfully
- **3. Franchise Operating Model**
review of your existing business model to allow it to be franchise operation
- **4. Franchise Manuals**
documentation of the franchise business in a series handbooks
- **5. Training and Audit**
creation of a comprehensive training and quality audit program to ensure that uniform brand standards are maintained all franchise units
- **6. Franchisee selection and approval**
creation of selection and approval process for new franchisees
- **7. Luanch the franchise**
Targeting of key markets and franchise partners and the successful opening of franchised business around the world

Who can become a Franchisor?

In theory, any person or company – who has developed or owns a brand and that has replicable, unique stand out points of difference in its operating sector – can become a franchisor.

A franchisor grants the license to another person or company to operate the franchised business under the franchisor's trademark. The franchisor owns the overall rights in the business model and trademarks and allows its franchisees to use these rights and trademarks to do business in exchange for fixed and ongoing fees.

Franchising is by no means limited to fast food restaurants and 'man and a van' type repair businesses. Where there is a unique and replicable offer such as a restaurant brand or service it can be franchised or licensed to a franchisee to develop and grow.

Franchising is an extremely efficient and fast route to growth and value add to a brand or company. A franchisor can grow far more exponentially than they may have done using their own manpower or capital.

Franchising is by no means limited to fast food restaurants and 'man and a van' type repair businesses. Where there is a unique and replicable offer such as a restaurant brand or service it can be franchised or licensed to a franchisee to develop and grow.



Who can become a franchisee?

Simply put, a franchisee is a business owner with a license to operate under a franchisor's trademark, trade name, and business model. Franchisees must follow certain rules and guidelines already established by the franchisor in exchange for fixed and ongoing fees and commissions.

There are three types of franchisee and the choice will depend on your existing expertise and funds available to invest. It is possible to be a franchisee for a single shop or unit. However, the more

profitable model for franchisees is to become an area developer or master franchisee. A master franchisee becomes the representative of the brand for an entire country, it manages a group of single shop owners, the sub-franchisees.

An Area Developer also becomes the sole partner of the brand in a territory ("area") but it does not sub-franchise, it owns all the shops that it opens.

		Franchisee	Master Franchisee	Area Developer
	Number of Stores	One	Multiple	Multiple
	Territory	No	Yes	Yes
	Exclusivity	No	Yes, subject to meeting KPIs	Yes subject to meeting KPIs

One of the many benefits of becoming a franchisee is the combination of entrepreneurial skills with a proven and viable brand. The job as a franchise owner is to duplicate the formula to generate a profit for yourself. There will be a rigorous evaluation process to be approved to run a franchise operation, and if there isn't, it probably isn't right for you.

Anyone, who meets the brand selection criteria, can be a franchisee, but you will require cash flow to satisfy the business plan, the right level of business experience for the franchise in question and a great relationship with the brand owner.

International franchising

As a franchisor, international franchising allows you to build and enhance your brand as a global player, and to reduce your dependence on your home market. Many international markets present growth opportunities that franchisors can develop to diversify their business and grow market share.

Franchising is growing exponentially in established markets such as the US, Canada, Australia, South Africa, and Europe, but also in emerging markets where we also retain expertise, such as Africa, Asia Pacific, and South America.

While opportunities abound, franchising beyond your home market can be challenging and you should consider and plan for the following issues when attempting to globalize your brand:

Culture and language barriers.

Just because your brand works in your home market does not necessarily mean it will work, look and feel the same way in other international markets. You might need to develop, change or amend your operating system, product range, menu, design, working practices or marketing campaigns to reflect local cultures and traditions as well as linguistic differences.

Trademarks and Intellectual Property.

As a franchisor, your brand, designs and knowhow are your most valuable assets. You need to ensure that your trademarks and other IP are available and protected in your target markets against potential copycats or pirates.

Local franchise laws. Most regions have their own laws, and some are more complicated than others. You need to gain an understanding of the laws across the jurisdictions in which you plan to operate to ensure your brand is protected and your agreements are aligned with law that will protect you. You will also need to ensure you are in compliance with all relevant legal and regulatory obligations.

81
countries

205
locations



20,000
professionals

12,000
lawyers

Map – July 2021

- Locations in purple represent Dentons offices.
- Locations in blue represent associate firms, offices and special alliances.
- Locations in green represent approved combinations that have not yet been formalized.
- Locations in gray represent Brazil Strategic Alliance.

Protecting your trademark, brand and knowhow

If you have a new brand then you should undertake extensive research to ensure availability of your brand name and trademark in your target territories.

Your trademark needs to be registered in each target country. As a franchisor, your entire system will be growing around your trademark and brand. You should consider trademarking your image and name and avoid any potential threat from another person who may later attempt to utilize the same or a confusingly similar trademark.

If you have already launched your franchise, it is important to ensure that you obtain registration and closely monitor the status of your trademark registrations.

Police your trademarks:

As a franchisor, you must police your trademark and monitor its usage by other businesses. Your business and brand will be expanding, and with that expansion comes additional scrutiny. Understand that even if your trademark is registered, your rights may be inferior to a local business with a common-law interest if that local business was in operation prior to the date of your USPTO registration.

Conduct trademark searches early on:

If you are at the franchise development stage, it's critical to conduct trademark searches to determine if your trademarks are protectable and available. If another business in the same industry has previously filed or obtained registration of a trademark that is the same as yours or confusingly similar to yours, then you may not be able to obtain registration and you may have to establish an alternative trademark and trade name.

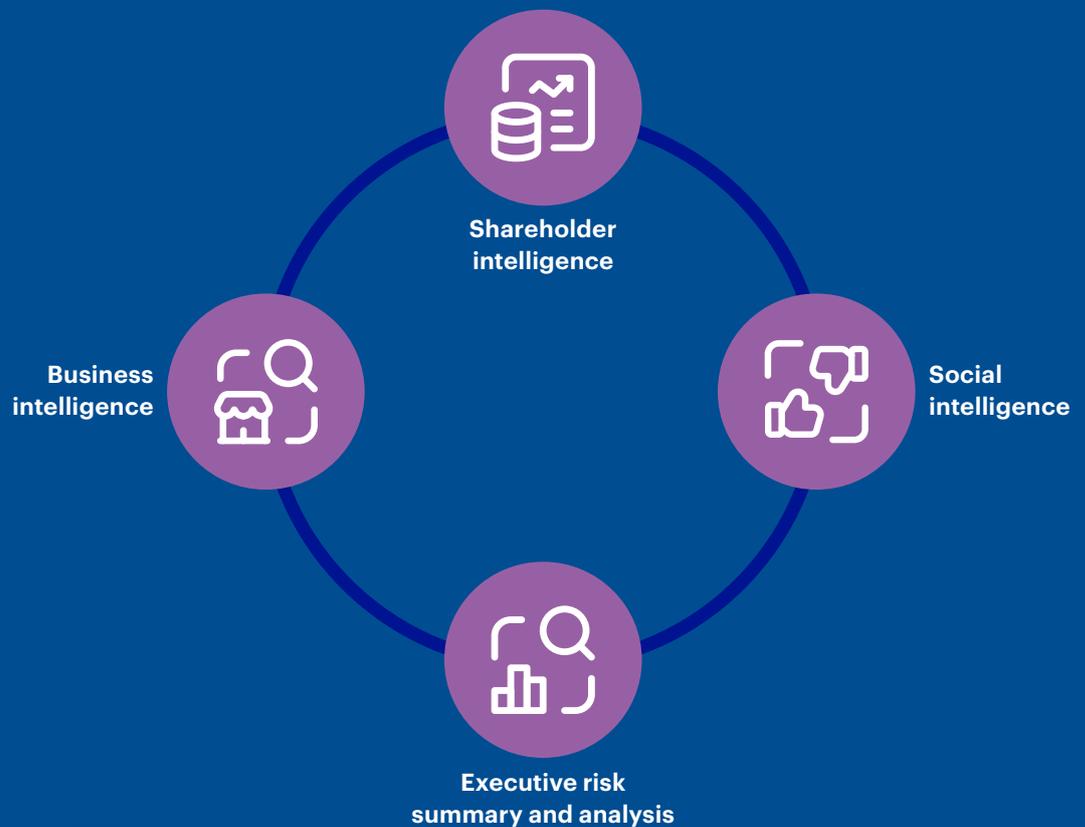
Prior to sending cease-and-desist notices to what you believe to be third-party infringers, you need to evaluate the third party's usage to determine if they possess any preexisting rights. If you license and grant a franchise in a territory where a third party possesses superior common-law rights, you may be exposing your franchise system and your franchisee to potential trademark infringement claims.

Partner selection and due diligence

Before entering into a franchise arrangement, both sides should undertake a thorough due diligence check, including detailed background checks on individuals and entities as part of wider anti-corruption, anti-money laundering or other compliance programs.

You will then need to create a comprehensive franchise partner selection and approval process, including, where appropriate, the creation of application questionnaires and investment committees.

As a good franchisor, you should demonstrate your credentials in your franchise sales deck and give each prospective franchisee an opportunity to understand the business model, visit stores, talk to management and review facts and figures. Good franchisors do not guarantee profit margins but they do provide a fully transparent due diligence process.



Financial models used in franchising

There are a number of fixed and ongoing fee models, the most common are listed here. Not all are applicable in every deal. Other fees can be applied, but these are a selection of the most common.

Joining or territory fee:

a one-off fee charged to pay for the exclusive rights and the initial training and support

Application fee:

a fee paid when signing an LOI to secure a territory for a negotiation period

Royalty:

ongoing fee, typically a percentage of revenue

Central service

fees: ongoing fees for marketing and support

Exit fees: a fee paid to exit an agreement early. Depending on the stage of exit, this can be as little as an admin fee, to as much as the entire value of the remainder of the agreement period.

Fees should be flexible and proportionate, so that both the franchisor and the franchisee earn a fair return on their investment. Otherwise, your franchise project will fail. If the franchise fee is excessive and the model too rich the franchisee will not invest beyond the first unit. It has to be remembered that the franchisee earns his or her revenue from the operation of the outlets whilst the franchisor generates income from selling franchises, providing paid for support services, and, in the case of retail franchising, from the supply of products for resale.

Fees must be balanced and realistic with the best interests of the future growth of the brand. It is in the interest of the franchisor to have the franchisee front and center of their success strategy.

The underlying reason for anyone wishing to franchise is the ability to generate 'perpetual' earnings through a win-win partnership.



Managing reputation

It is in the mutual interests of both parties to ensure the brand maintains its reputation and has a monitoring tool in place to manage on and offline reputation. A positive brand reputation can drive the value of the brand, ability to collect richer fees, and of course the overall profitability of the brand in the interest of both franchisee and franchisor.

Your toolkit to facilitate quality and reputation management should include:



Comprehensive training program



Quality audit and scoring program



Remedial training program



Loyalty program

A good reputation and quality management program will set you apart from your competitors with AI and machine learning technology enabling you to rectify feedback fast and ensure you become number one in your benchmark competitor group.

Dentons Franchise Advisory is here to help!

It can be difficult identifying advisors, who truly understand the international franchise business model. Dentons Franchise Advisory fills this gap. A leading franchise law firm globally, Dentons represents more than 400 franchise systems in over 85 countries. We have worked in the franchise business since its very beginnings. Backed up by more than 200 offices in 80+ countries, we offer you a one-stop-shop for your advisory needs.

Value proposition

- **A team dedicated of franchise advisers.** This is all we do. Whatever your challenge, chances are we've already helped clients in a similar situation.
- **Practical solutions.** We are a solutions-driven team that understands the franchise industry and how it works.
- **Business and law.** The team combines leading franchise lawyers and well-known business consultants who have worked with some of the world's leading brands.

Assisting you at each phase of your franchise journey



- **Franchise discovery and planning workshops:** Conducting an exploratory session to help you understand how franchising works and craft your franchise strategy.
- **Franchise business case:** Developing/refining your franchise business case and plan, conducting a feasibility study, and exploring your potential strategy.
- **Market entry strategy:** Determining whether you need to adjust your store design, product range or menu offering to succeed in new markets, and assisting with legal and compliance issues.
- **Operations manual and design manual:** Developing a detailed operations manual to ensure compliance, knowledge transfer and a disciplined franchise network, and a design manual to ensure a consistent look and feel in all franchised units.
- **Partner selection and due diligence:** Performing background checks and due diligence on franchise candidates as part of your anti-corruption, anti-money laundering or compliance programs. Developing a comprehensive franchise partner selection and approval process.
- **Brand matching:** Assisting with brand and operator selection and other preparatory steps, including brand to identify potentially suitable brands and brand partners.
- **Leadership training:** Training to help senior managers understand how franchising works, how to maintain uniformity, and how to generate new business.
- **Franchisee training:** Training for the brand manager, leadership and/or staff on the franchisee side on management, business skills and operational matters.
- **Quality inspection:** Monitoring the performance and health of your franchisees, including adherence to brand standards and customer satisfaction. Assisting with remedial actions.
- **Financial modelling and critique:** Developing and assessing the proposed financial model, and benchmarking against best-in-class franchise businesses.
- **Trademarks and intellectual property:** Ensuring your trademarks are available, registered and protected in your target markets, and enforcing intellectual property rights against infringement.

Contact



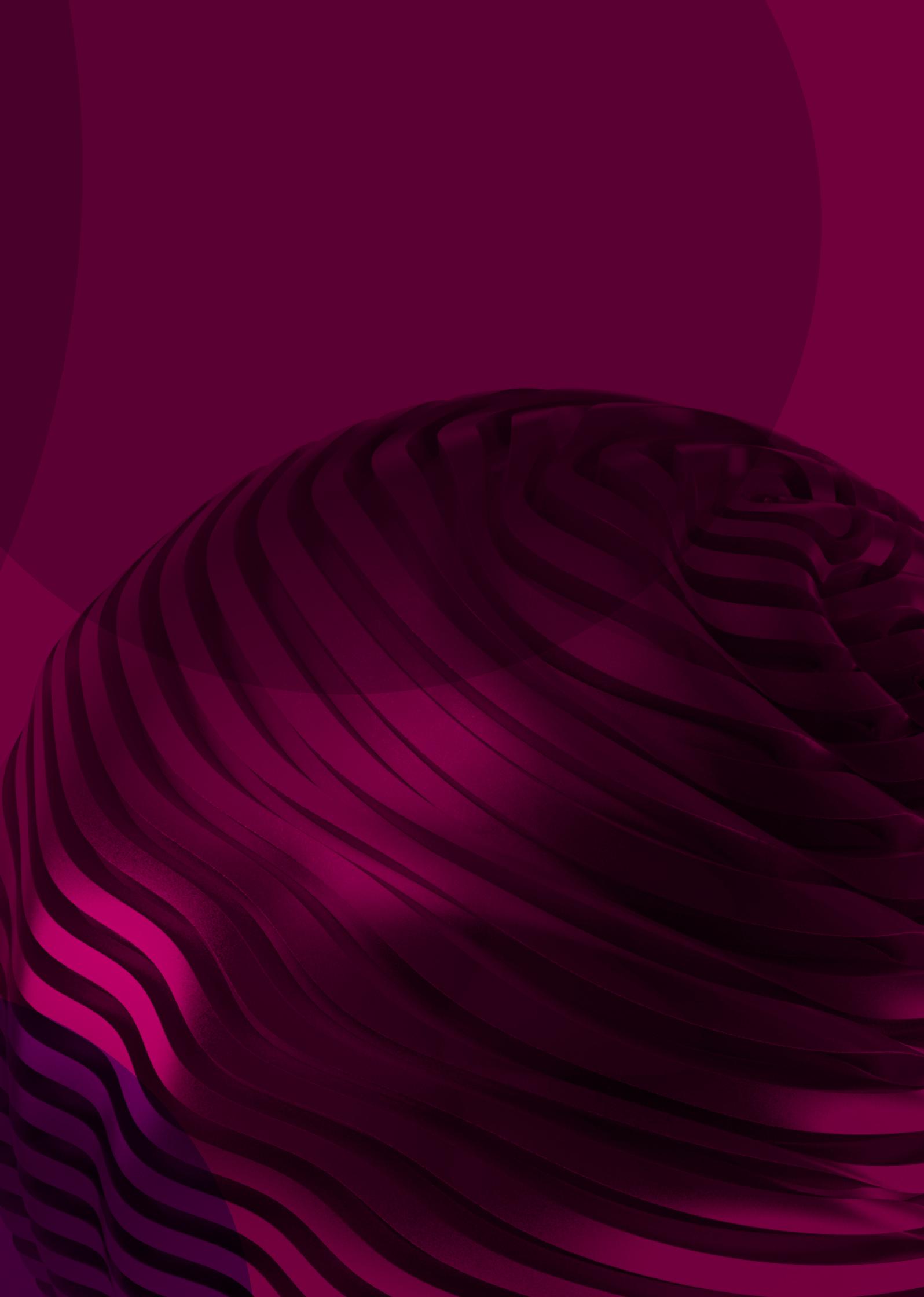
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ABOUT DENTONS

Dentons is the world's largest law firm, connecting top-tier talent to the world's challenges and opportunities with 20,000 professionals including 12,000 lawyers, in more than 200 locations, in more than 80 countries. Dentons' polycentric and purpose-driven approach, commitment to inclusion and diversity, and award-winning client service challenge the status quo to advance client interests.

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