WFD Wollermann FRANCHISE DEVELOPMENTS

International franchising - legal advice

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Franchising has developed in Australia through well-known international brands. Foreign Franchisors are looking to Australia and New Zealand as potential markets to expand their brand.

A number of foreign Franchisors have now successfully entered the Australian market via a variety of business arrangements, such as;

- Master Franchising
- Direct Licensing to a single or multi-unit Franchisee
- Area Development Agreements
- Partnership, Joint Venture or Partnering Agreements

Master franchising

This is the most common model adopted by foreign Franchisors. The advantage is that effectively the obligations of the foreign Franchisor are taken up by the Master Franchisee.

An advantage to the foreign Franchisor is that it is not contracting directly with individual Franchisees and therefore, legal liability, risk and possible action, rest with the Master Franchisee under Australian law.

The Master Franchisee becomes responsible for compliance with the Franchise Code under the Trade Practices regulations, recruiting Franchisees, meeting performance criteria, training and support of Franchisees, and all associated costs of establishing infrastructure to ensure the system operates successfully. Foreign Franchisors may already have world wide brand recognition and systems in place which can be used to support the Master Franchisee.

The risk ultimately is choosing the right Master Franchisee. It can make or break the successful roll out of the brand. A disadvantage of Master Franchising is that, although there are controls via the Master Franchise Agreement, the Franchisor is one step removed from practical control and face to face management is left primarily to the Master Franchisee. If they truly have the ability, personality and skills they will succeed. If not, it can be a disaster.

Our experience shows a number of foreign Franchisors with global recognition do little by way of actual due diligence or market research. Common mistakes are underestimating the size of the Australian market, not taking into account differences in the market, demographics and differing consumer demand and tastes between States, for example, a franchise system highly successful in Queensland, may not transport well to Victoria.

In addition, a number of foreign Franchisors ask for master license fees, which are unsustainable in our market with little regard to any return on investment to the Master Franchisee.

Additional marketing may be required where the brand is not well known. The cost of supporting and maintaining a Master Franchisee, both in terms of training, conferences can be substantial.

Master Franchising is however, favoured by foreign Franchisors, as they can quickly replicate their system and maintain a degree of control over their brand and system through their Franchise Agreements. The management and recruitment of Franchisees is however left to the Master Franchisee. There is a price to be paid for this to

the foreign Franchisor,, however as the fees payable flow through the Master Franchisee and back to the Franchisor so there is a split of the revenue stream, this being the cost having another entity responsible for day to day management and control.

Direct franchising

The Franchisor grants the Franchise direct to an individual Franchisee.

The Franchisee may be given the right to establish more than one Franchise in a state or territory. Here the Franchisor has more direct involvement and control in relation to the Franchisee. The Franchisee Contracts with the foreign Franchisor directly. The Franchisor is usually well established and confident in its systems and business format to support and control the Franchisee from abroad. Direct franchising can be suitable subject to the business type. It tends to be more suitable for a traditional retail franchise format.

It may not be as attractive a model to Franchisees, as they may be concerned of the lack of a local presence by the Franchisor in relation to systems, support and training, as their support, maintenance and communication with an overseas entity. This is less of an issue in these days with modern communications, however there is still the absence of direct face to face contact.

Direct Franchising is not that common. The advantage to a Franchisor is that the revenue, reverts directly back the foreign Franchisor, there being no local corporate presence.

Area development arrangements

These are becoming more popular enabling foreign Franchisors to effectively test the market by appointing an area developer who is engaged to find and secure Franchisees.

The area developer may be given strict performance criteria. The area developer does not contract with Franchisees as they are effectively an agent appointed to promote and secure Franchisees. The Franchisees contracts the foreign Franchisor directly. Again this means that the foreign Franchisor has direct control over its Franchisees.

The Area Developer may be paid a percentage of upfront fees and ongoing Franchise fees and may be required to provide additional services to support Franchisees. The Area Developer becomes the only Franchisee appointed in the territory. However, Franchisees enter into Franchise Agreements directly with the foreign Franchisor.

There is a degree of risk to Franchisees in this model, particularly if they are taking up multi unit Franchises, due to the capital expenditure they need to outlay, without knowing the success or otherwise of the business model.

Joint ventures or partnering agreements

There are a number of models where foreign Franchisors and local Franchisees enter into a joint venture and/or partnering arrangement, usually via a nominee local company or trust where shares or units are held by each of the parties.

The nominee local company then becomes the vehicle and trading entity that is the Franchisor. The parties enter into a Partnership, Shareholder or Joint Venture Agreement governing their respective rights and obligations. This has the advantage of direct commitment by both parties, who have a vested interest to ensure success in the market.

The foreign Franchisor also retains a degree of control and direct access to profits, from the business operation rather than just a proportion of Franchise fees payable.

Code changes impact on foreign franchisors

Changes to the Code from 1 March 2008 now require all foreign Franchisors to comply with the Code, including providing a Disclosure Document to its Master Franchisee.

We are now seeing an impact on foreign Franchisors in relation to this additional requirement as it delays the roll out and appointment of a Master Franchisee. The Master Franchisee must also provide each Franchisee, with a copy of their own Disclosure Document, as well as the one provided by the Franchisor. Alternatively the Franchisor and Master Franchisee may give a joint Disclosure Document.

Ultimately the Master Franchise remains primarily responsible for compliance with the Code in respect to individual Franchisees.

Foreign franchise agreements

Other issues that need to be considered for foreign Franchises is the conversion of their overseas agreements to comply with the Code. The agreements usually require adjustment to meet dispute resolution provisions and comply with the Code.

The issues of jurisdiction and governing laws also need to be considered.

We see a number of overseas franchise agreements that are still quite antiquated in their style, form and language. They are difficult to read and are set out poorly. This can have an impact on whether Franchisees proceed to enter into the arrangement.

If the documents are well set out and clear in their language it is more likely that the process of obtaining advice and signing up of the Franchisee will be a less costly process, and more comfortable to both parties.