The Formula for Success in International Master Franchising

by Carl E. Zwisler

7 Ways to Increase Your Chances of Success in International Master Franchising

1. Set achievable expectations for the franchisor, the master franchisee and the territory. This requires market research, financial modeling and a detailed business plan.
2. Obtain a long term commitment of the franchisor's CEO and board to international franchising.
3. Budget for the costs and time needed to realize profits from the international program and from each master franchise that will be granted.
4. Confirm that each master franchisee's expectations and business plans and business ethics are aligned with those of the franchisor, and that both parties have all the resources needed to execute the plan.
5. Confirm that the master franchisee understands what can go wrong in its execution of the plan and what will happen if problems arise.
6. Involve the best international franchising lawyers and consultants in the planning and execution the international franchising program.
7. Do not agree to terms in a letter of intent before understanding the legal, tax and other implications of a proposed transaction.

International master franchising is the most sophisticated form of franchising expansion. It is typically the most expensive form of international franchising program to establish, and often takes longer to generate profits than the other most common forms of international franchise expansion, unit franchising and area development franchising. Master franchising is also the most prevalent form of international expansion used by franchisors. And, because of its complexity, it is the form of international franchise expansion that is most likely to result in problems. With all of its challenges, however, master franchising programs and agreements, when structured to address the most common problems, can be highly successful. By following the steps discussed below, franchisors can avoid or mitigate costly mistakes.

What do we mean by "master franchise" or "area development franchise." Here are our definitions:

An "area development franchise" involves only two parties, the franchisor and the area developer. The area developer is granted a territory within which he must open an agreed number of franchised outlets. Before opening each outlet, the area developer must sign a unit franchise agreement. Nonrefundable fees are usually paid for the development rights. Additionally, initial franchise fees and royalties are typically paid pursuant to each franchise agreement.

Three parties are involved in a "master franchise program". The franchisor signs a master franchise agreement with a master franchisee granting a territory that must be developed at a rate established by a development schedule. The master franchisee is usually required to open one or more franchised outlets himself or through an affiliated company, and he also has the right to grant franchises to third parties (subfranchisees). The master pays a nonrefundable fee for the rights to the territory, and agrees to pay the franchisor a portion of the initial and ongoing fees derived from each outlet in the territory. Each outlet operates pursuant to a subfranchise agreement to which the master franchisee and a subfranchisee are parties, but typically not the franchisor.

WHAT COULD POSSIBLY GO WRONG?

The principal problem experienced by international franchisors and master franchisees is that they don't articulate their respective expectations for their relationship. They don't quantify their reasons for targeting a particular territory, country or franchise "partner". They don't identify what they are likely to spend on each transaction, how the master franchisee candidate will generate the profits needed to make the investments worthwhile, and what level of growth and unit performance is needed to generate profits needed to justify the investment.

With articulated expectations, franchisors can assess potential markets, candidates and the plans that need to be developed to exploit opportunities. Unless every party involved in master franchise programs, franchisor, master franchisee and subfranchisee achieves his minimum goals, the program cannot succeed.

Because international franchising typically requires more time and resources for success than does a comparable investment in additional franchise development in a franchisor's domestic market, establishing realistic expectations for, and obtaining the full support of, the franchisor's CEO, and board of directors is critical to the success of an international franchising program. Demands for generating quarterly profits from a start-up international franchising program are usually inconsistent with the realities of international franchising, which often requires 3-5 years before a franchise achieves profitability in a market.

PLANNING FOR FAILURE BY NOT PLANNING FOR SUCCESS.

Every business plan requires a thorough evaluation of the opportunities for generating revenues and profits, as well as a fundamental understanding of the capital and marginal expenses that are needed to achieve profitability. Franchisor executives and prospective master franchisees who lack international franchising experience frequently underestimate the range of expenses that they will incur in an international master franchising program. Beginning an international franchising program without budgeting for the likely costs is like taking off in an airplane without understanding how much fuel will be needed to reach the planned destination. Although a list of the typical costs of international franchising is too long for inclusion in this article, it is available [in Zwisler and Krakus, "Avoiding Common Mistakes in International Franchising," International Journal of Franchise Law, International Journal of Franchising Law Volume 14 – Issue 3 – 2016, pages 12 and 13.] [from the author]

When developing their business plans, both the franchisor and the master franchisee candidate should clearly identify each likely cost and when each cost will be incurred, and the source of funding for the cost. They should also use market research to assess likely average unit volumes and budget conservatively.

When developing their cost models, franchisors should assess which franchising format will work best in each targeted territory. Territories that will not support a significant number of outlets will often not warrant the expense of using master franchising. Area development may be a better approach. Although master franchising is designed as the fastest growth model, the initial cost of establishing a master franchising program and of localizing it in a new country is generally more expensive than the cost of using area development franchising.

INVOLVE INTERNATIONAL CONSULTANTS AND LAWYER EARLY

Top international franchise lawyers and consultants provide expertise needed to develop international franchising plans. They should be able to identify the best franchising strategies for use in a given transaction, identify problematic or costly markets, and help to prepare budgets for each transaction. International franchise lawyers should prepare form international agreements, LOIs, and disclosure documents that both protect the franchisor and avoid unnecessary negotiation. They should alert franchisors to legal, tax and IP issues that are likely to affect net returns from doing business in each new country before a franchisor initiates a transaction in a new country. Lawyers also provide strategies for minimizing agreement registration and translation costs, minimizing withholding taxes and expediting cash flow.

Ultimately, by focusing on goals, preparing and executing plans with master franchisees who share a franchisors goals and culture, franchisors have a great chance for success in international franchising.

Meet The Author

Carl Zwisler, an international franchising lawyer, is a member of Gray Plant Mooty's highly esteemed franchise practice group in Washington, DC. He represents franchisors and master franchisees from throughout the world in structuring and negotiating international agreements. He regularly advises companies that franchise into the U.S. from abroad. Carl has prepared and delivered more than 200 presentations and articles on international franchising. He formerly served as IFA's General Counsel.

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