World Conquest: The Do’s and Don’ts of International Franchise Expansion

William Edwards
Edwards Global Services, Inc.
Irvine, California

Edward (Ned) Levitt
Aird & Berlis LLP
Toronto, Canada

Harold Kestenbaum
Gordon & Rees LLP
East Meadow, New York
## GlobalVue™ - How Countries Compare

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>3</td>
<td>2</td>
<td>3</td>
<td>2</td>
<td>2.0</td>
</tr>
<tr>
<td>Urban China</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>1.7</td>
</tr>
<tr>
<td>Australia</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>1</td>
<td>1</td>
<td>1.8</td>
</tr>
<tr>
<td>Middle East Region/GCC</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>2</td>
<td>2.2</td>
</tr>
<tr>
<td>Mexico</td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>2.0</td>
</tr>
<tr>
<td>Canada</td>
<td>1</td>
<td>3</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>1.8</td>
</tr>
<tr>
<td>USA</td>
<td>1</td>
<td>3</td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1.5</td>
</tr>
<tr>
<td>Spain</td>
<td>1</td>
<td>4</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>1.8</td>
</tr>
<tr>
<td>Chile</td>
<td>2</td>
<td>1</td>
<td>3</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>2</td>
<td>1.7</td>
</tr>
<tr>
<td>India</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>3</td>
<td>2</td>
<td>2.0</td>
</tr>
<tr>
<td>Brazil</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>2</td>
<td>1.8</td>
</tr>
<tr>
<td>Russia</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>4</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>2.8</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>2</td>
<td>3</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>1.7</td>
</tr>
<tr>
<td>Germany</td>
<td>2</td>
<td>4</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>1</td>
<td>1</td>
<td>1.4</td>
</tr>
<tr>
<td>Singapore</td>
<td>3</td>
<td>1</td>
<td>4</td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>1.7</td>
</tr>
<tr>
<td>Viet Nam</td>
<td>3</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>4</td>
<td>2</td>
<td>2.0</td>
</tr>
<tr>
<td>South Korea</td>
<td>3</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>3</td>
<td>2</td>
<td>2</td>
<td>2.3</td>
</tr>
<tr>
<td>Japan</td>
<td>3</td>
<td>3</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>1.7</td>
</tr>
<tr>
<td>France</td>
<td>3</td>
<td>4</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>3</td>
<td>1</td>
<td>2.3</td>
</tr>
<tr>
<td>Italy</td>
<td>3</td>
<td>4</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>2.2</td>
</tr>
</tbody>
</table>

Country Ranking: 1 is good, 2.5 is fair, 4 is worst - Sorted first on Franchise Potential

rum, EGS GlobalTeam™ in 25 countries
## Clear Differentiation Is A Marketing Tool

This is your chance to focus on what your franchise does best!!!!

<table>
<thead>
<tr>
<th>Special Brand Features</th>
<th>Denny's</th>
<th>Applebee's</th>
<th>IHOP</th>
<th>KFC</th>
<th>Papa John's</th>
<th>Chili's</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ranked by 'Entrepreneur' in the top 10 of all US franchises</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>58 years of operating experience</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>More than 2,100 restaurants worldwide</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>24/7 - Breakfast/Lunch/Dinner/Late Night menus</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Full Service / Table Service</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Operations in 8+ countries</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Unit Restaurant Models form 70-800 square meters</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Average annual single restaurant revenue US$1.7MM</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>d Slam</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>High value priced menu focus</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>
International Financial Model

• **Must be a Win-Win-Win**
  - At the Unit, Master and Franchisor levels
  - Know the respective Start-up and Operating Costs
  - And project the respective net revenues by country

• **Value Proposition v. Revenue Share**
  - Consider brand Value
  - Roles and Responsibilities / Level of Support by Franchisor and Master Franchisee
  - Know the operating costs in each country
  - Investment, Risks, ROI
Are Changes To Your Franchise Necessary???

- Denny’s® in India: no beef and no pork
- Carl’s, Jr. ® in Viet Nam: add pasta
- Mr. Handyman®: do in-home estimates and price by job rather than by the hour
- All US service brands: add more training so systems are followed
- All US food brands going into Asia: more chicken on the menu
Right At Home® Senior Care
In Brazil And China

• Focused on the new generation 2 income middle class family with no time for family care

• Introducing a professional system into a market with nothing similar to date

• Making the case for paying for a professional, trained, certified in home care provider

• Transporting a high level of training and certification to a new market
Carl’s, Jr. ® And Round Table Pizza® In Viet Nam

- More limited menu than in most countries – supply chain, but add pasta dishes
- High food supply and quality issues
- Early to market – little western brand competition
- Seek licensee with western background and brand experience
- Prime real estate challenges
Country Factors To Consider When Choosing Where To Franchise

- Rule of Law
- Country Stability
- Intellectual Property Protection
- Good GDP Growth = Investors
- Clear Market Differentiation
- Potential to Achieve An Acceptable ROI
Top Franchise Markets For 2012/2013

- China – Focused on 1st and 2nd Tier Cities
- India – Strong desire for food and retail brands
- The Middle East – specialty food, retail, personal service
- Indonesia, Malaysia, Thailand, Viet Nam - niche brands
- Other Latin America – Chile, Colombia, Peru
## Most Desired License Types By Sector

### '1' Is Most Desired

<table>
<thead>
<tr>
<th>Country Or Region</th>
<th>Education</th>
<th>Food</th>
<th>Retail</th>
<th>Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>3</td>
<td>2</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Brazil</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Canada</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Urban China</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Colombia</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>India</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Indonesia</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Ireland</td>
<td>3</td>
<td>2</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Japan</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Mexico</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Middle East</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Philippines</td>
<td>2</td>
<td>1</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Singapore</td>
<td>2</td>
<td>3</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>South Africa</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>South Korea</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Spain</td>
<td>3</td>
<td>2</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>Turkey</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>3</td>
<td>2</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>USA</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Viet Nam</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
</tbody>
</table>

More developed countries trend towards service, emerging markets toward education

Based on an EGS GlobalTeam™ survey in 25 countries
A Proven International Development Strategy

- Budget conservatively for the first 3-5 years
- Be realistic in your initial fee expectations
- Realize that initial fee revenues have corresponding, associated expenses over time
- Be realistic in how many countries you can award and properly support
- Plan ahead for marketing, training and support costs
TIMING

• Don’t leave home until you are ready
• Speed kills
• Take some breaks
• Be ready for opportunity
• There are many approaches to expanding a franchise system.
• The complexities increase the more the efforts, capital & resources of independent parties are involved.
FACTORS

- Available Capital
- Business Goals
- Business Philosophies
- Human Resources
AVAILABLE MODELS

- Direct Franchising
- Area Franchises
- Master Franchising
- Area Representative
- Joint Venture Franchising
- Acquisition
PROS & CONS

- Slower growth
- More capital
- More control over operations & quality
- Narrower penetration of markets

- Faster growth
- Less capital
- Less control over operations & quality
- Broader penetration of markets
DIRECT FRANCHISING

• Greater opportunity to control the system
• A good place to start
• Can set the tone and standards for the future in the target market
• Harder to sustain in the long run
• More ongoing legal considerations:
  – franchise statutes, support, enforcement
AREA FRANCHISES

- Multi-unit franchising
  - can arise from rights of first refusal
- Middle ground on issues between master franchising and direct unit franchising
- Can couple with area representative arrangements to increase effectiveness
MASTER FRANCHISING

- Most common model in international franchising
- Least amount of control of the system
- Very effective at the right time
- Choosing the master franchisee is crucial
- Master franchisee becomes a franchisor
JOINT VENTURE FRANCHISING

• Possible in any expansion model
• Advantages:
  – control at two levels
  – better bottom line
  – more hard assets
  – partnership feel
• Disadvantages:
  – more commitment of resources
  – increased franchisee expectations
  – possible legal complications
ACQUISITION

- Non-franchised competitors
- Franchised competitors
- Conversion issues
  - Territorial encroachment
  - Costs to franchisees
  - Different cultures
  - Different levels of support
INTELLECTUAL PROPERTY

- Trade marks
- Copyright
- Patents
- Know-how
- Domain names
- Internet presence
- Goodwill
TAXATION

• Different model – different tax result
• “Doing business” and “permanent establishment”
• Withholding tax
OTHER LEGAL CONSIDERATIONS

• PAYMENT
  – exchange controls, security, guarantees (Alberta)
• Enforcement
• Supply chain issues
  – import duties, labeling, standards, quotas and restrictions
Which Countries Have Franchise Laws?

Australia, Belgium, Brazil, Canada (provinces of Ontario, New Brunswick, Alberta, Prince Edward Island, and Manitoba), China, France, Indonesia, Italy, Japan, Kazakhstan, Lithuania, Malaysia, Mexico, Romania, Russia, South Korea, South Africa, Spain, Sweden, Taiwan, Vietnam
• Some of these countries are simply disclosure law requirements, like Ontario and Sweden; while others require a full registration prior to selling franchises, like, Brazil and Vietnam.
• The penalties for violating these laws can be severe in some countries, and minor infractions in others. There are rarely penalties in the disclosure only countries, but monetary penalties in the pre-sale registration countries.
• Some of the laws in some of these countries are only relationship laws, like in Kazakhstan.
• The benefit of offering franchises in foreign countries that have no franchise legislation is that the US franchisor can accept deposits to cover the cost of their upfront legal fees, like document preparation and trademark registration. This will determine whether the prospects are real or just simply “tire kickers”.
The goal is to always try to determine the viability of the franchisee prospects before spending significant money to comply with the laws of a particular country. The problem is that in the disclosure/registration countries, accepting money before the documents are filed or prepares is illegal.
The advice that I give to all of my clients is to determine in advance whether the prospects they are speaking with are from a country that does or does not have any franchise legislation. This will save a great deal of time and money.
Deal Points to Be Aware Of

• Once compliance with franchise legislation is resolved you need to turn your attention to some key contract provisions

• One of the first key provisions is the territory
  – the Franchisee wants the world, the Franchisor wants the territory to be a little smaller
  – the Size of the country influences the number and size of the territories, i.e. Kuwait vs. UK, France or China
  – With larger countries it may be better to have several area franchisees rather than one master franchisee for the entire country”
Term of the Agreement

• The length of the term of the agreement is always ripe for negotiation.
  – Franchisees want forever
  – Franchisors want a little shorter term

• It is not good business practice to tie up a territory for long periods, particularly when you have no idea how well the franchisee will perform.
Determining the Fee to Charge

• Whatever the market will bear?
• Financial analysis?
• One size does not fit all.
• Start with how many units can reasonably be developed, then multiply by the franchise fee for each unit.
• Mistake to charge too much or too little.
Choice of Law

- One of the most contentious issues to in negotiating International deals (and domestic for that matter).
- U.S. Franchisors comfortable with what they know.
- Foreign Franchisees want their local law to govern.
- Is there a compromise here? Maybe. This would be to concede to the local law, but insist that the venue be in the USA. That topic is next.
Venue/Jurisdiction

• Often a deal killer.
• But here are some alternatives:
  – (a) choose a neutral locale, like the London, if you are dealing with a Middle Eastern franchisee;
  – (b) choose New York City, as opposed to say Oklahoma or Texas (it is easier to travel to); or,
  – c) just agree to the home country, but insist that all proceedings be in conducted in English. This way, at least you will understand what is going on.
Where Will Training Take Place and at Whose Expense?

• Foreign franchisees often insist that the franchisor bring over their staff to train the franchisees in their home country.

• U.S. Franchisors may agree, but they want salaries and expenses covered.

• If training in the U.S., the question arises as to how many will be trained.
Frequency of Visits

• This is another issue that is often negotiated and the Franchisor tries to limit its trips over, while the franchisee would like a visit every month! This is never going to happen and most US franchisors try to limit visits to quarterly at most.
Advertising Contributions

• U.S. Franchisors want contributions to U.S. fund.
• Foreign Franchisees want money spent in their countries.
• The argument that franchisors make is that it is for brand recognition, which is global.
• At the end of the day, this is not a deal breaker and U.S. Franchisors will usually concede this point.
Conclusion

- US franchisors should maintain the integrity of their agreements, but not to the point of losing the deal. They need to keep in mind that this is not the U.S. and they may just have to make concessions on these deals that they would never make on their Domestic deals.