

Corporate Commercial

The franchise model and process for franchisors



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A - Why is franchising appropriate?

1. Many established businesses have found that franchising provides the ideal opportunity to expand their business and increase their presence in the market place. Franchising is a licence arrangement whereby an individual or company (the "franchisee") is permitted by a company (the "franchisor") to operate a business under the franchisor's trade name or trade mark and to use the franchisor's established business system. The advantages to the franchisor are that:

- the capital requirements in establishing additional outlets are borne by its franchisees;
- the number of employees a franchisor needs to run the franchise network is less than a business would need to run a network of company-owned outlets;
- the franchisor does not become involved in the day-to-day operation of each franchised outlet;
- the franchise network can grow quickly as the franchisor can concentrate on recruiting and training franchisees and developing the infrastructure necessary to expand the franchise network;
- the franchisor can earn a profit from its successful franchises;
- greater economies of scale/discounts can often be achieved by an increased requirement for volumes of products sold by additional outlets;
- the goodwill associated with the business and franchise network is retained by the franchisor.

2. There are normally two circumstances in which businesses set up franchise operations:

- (i) Where a successful business currently exists and wishes to expand.
- (ii) A business can be specifically formed with the intention that it is to be franchised.

3. We believe that the franchising model is one that could suit your business if:

- Your business is a nationally well-known brand with a substantial number of outlets operating throughout the United Kingdom;
- the franchising model could be used by your business to complement its existing outlets;
- franchising could enable your business to open a substantial number of additional outlets more rapidly and at a reduced cost than your business could do itself;

- the additional volume for wines and other products sold by your business should also result in a greater purchasing power/bulk discounts;
- existing managers within your business network might be more motivated to work hard within your business's existing network if they know they might get a chance to buy a franchise of your business.

B - Suggested franchise structure

1. By way of example only, a proposed franchise structure is set out in Figure 1.

2. The proposed structure would need discussing with the franchisor's accountants/tax advisers to fully consider the accounting/taxation implications to the franchisor. However, we would suggest that a new subsidiary company ("Newco") is formed to act as the franchisor. Newco would take a master franchise from the franchisor's trading company and then be responsible for the granting of all subsequent franchises. The franchisor's current outlets would continue to be owned and operated by the franchisor. (Some of these outlets could be sold to franchisees and operated as franchises.) By taking the franchise side of the business out of the remit of the franchisor's trading company, any potential liability to franchisees for the franchisor's trading company is ring-fenced. The Newco would enter into agreements directly with franchisees and be responsible for the day-to-day operation of the franchise business, thus allowing the franchisor's trading company to concentrate on the business of operating its existing outlets.

C - The franchise process

The franchise process is set out in Figure 2.

The steps and documentation required to grant a franchise are as follows:

1. Confidentiality Agreement – this protects confidential information in the preliminary stages of negotiations and discussions.
2. Deed of Commitment – this is entered into upon payment of a deposit by the potential franchisee to secure their right to be granted a franchise in a given territory whilst appropriate premises are located. If within a certain period of time the franchise agreement is not entered into or the franchised business is not operational, deposits....

and other monies paid up to that date would be refunded to the franchisee less any expenses or costs incurred by the franchisor in relation to the investigation and identification of premises, any initial training provided, legal fees incurred and other work to date.

3. Franchise Agreement – we suggest that the main terms of a Franchise Agreement would be as follows:

- Term – a term of 5 years could be granted with the option to review for a further 5 years.
- Initial fee – this would cover the costs of business set-up, training and the launch of the business. The fee also takes account of the goodwill associated with the brand. As other brands within Oddbins' sector grant franchises, such as Threshers and Bargain Booze, the initial fee would need to be benchmarked against the typical initial fee charged by those franchises.
- Ongoing fees – these fees tend to cover the ongoing management of the network by the franchisor and the marketing undertaken by the franchisor. They tend to be a percentage of the gross turnover of the franchise.
- Marketing – national marketing would be undertaken by the franchisor and local marketing by the franchisee. A small percentage of turnover could be charged to cover such marketing.
- Personal Guarantees – a personal guarantee from each individual director/shareholder of the franchisee should be required.
- Purchase obligations – to purchase all stock from Oddbins (this would need to be assessed for compliance with UK and EU competition law).
- Restrictions on the franchisee and guarantor during the term of the franchise agreement and for a period of time following termination to prevent them from carrying on any competitive business in competition with the franchisor either from the premises or in the territory.
- Provisions concerning material operational matters such as use and operation of EPOS systems.

4. Trade Mark Licence – this governs the terms on which the franchisee can use the registered or unregistered trade marks of Oddbins in connection with the operation of the franchised business.

5. Sub-Lease – Newco would take a head lease of the premises so that Newco would be in a stronger position to monitor and manage what is to happen to the premises on termination of the franchise agreement. The sub-lease would automatically terminate on termination of the franchise agreement. All sub-leases would be excluded from the security of business tenure provisions of the Landlord and Tenant Act 1954 to avoid franchisees having security of tenure.

D - Pilot scheme

The first step in establishing a franchise network is to operate a pilot scheme. The British Franchise Association (the "BFA") requires franchisors to have operated a pilot scheme for twelve months as a pre-condition to membership of the BFA. We would suggest that Oddbins looks to its upper quartile performing outlets and identify two or three outlets to operate as franchises. Such franchises could be offered to regional managers or existing managers of those outlets. It is usual for the initial franchises being granted to be offered at a reduced percentage of between 70% to 80% of the initial fee. The incentive for current managers is that they are given the opportunity to own and build their own business. The benefit to Newco/Oddbins is that the manager has already been successfully operating the business and therefore the risk of the franchise not succeeding is reduced and the requirement for training and a launch of the franchise is not necessary as the outlet is already in existence and operation. Oddbins' current business model would be replicated in each franchise outlet to ensure consistency across the board. Any current policies, procedures and handbooks in place with Oddbins could be utilised and form part of the franchise business operations manual. The operations manual is the franchisor's bible, containing all of the information required by a franchisee to set up, operate and manage a franchised business.

E - Marketing of the franchise concept

If you decide that franchising is the way forward for the expansion of your business, various steps can be taken to advertise the fact that Newco is a franchisor. We would suggest that you consider carefully whether you wish for your business to become a member of the BFA. The BFA is responsible for monitoring and ensuring that its UK members comply with the European Code of Ethics for Franchising. The BFA also offers a number of seminars and events to assist both franchisors and franchisees in the business of franchising. The BFA holds exhibitions at various stages throughout the year throughout the United Kingdom and we would suggest that you look to exhibit at these events in order to market its franchising business and opportunities. There are also various franchising publications that you could advertise in.

F - Our involvement

1. Linder Myers LLP is an affiliate member of the BFA and has considerable experience of advising franchisors. We would be able to assist you in setting up and establishing the franchise network, drafting the initial suite of franchise documentation and acting on your behalf in connection with:

- the granting of any new franchises;
- preparation, negotiation and execution of head leases/ sub-leases;
- sales, renewals or transfers of existing franchises;
- termination of franchise agreements and any other matters relating to the franchise network.

2. We propose that a case management system is implemented in order that details of each franchise agreement can be stored and renewal dates diarised to ensure the effective management of the franchise network.

We would welcome the opportunity to meet you to discuss your franchising plans.

Figure 1: Proposed Franchise Structure

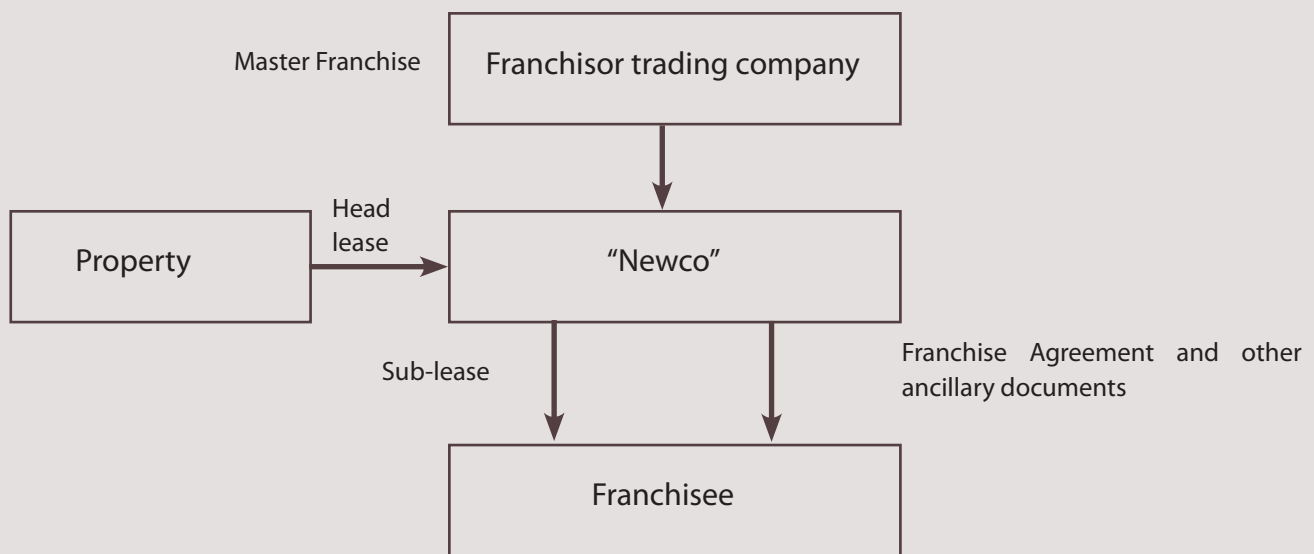
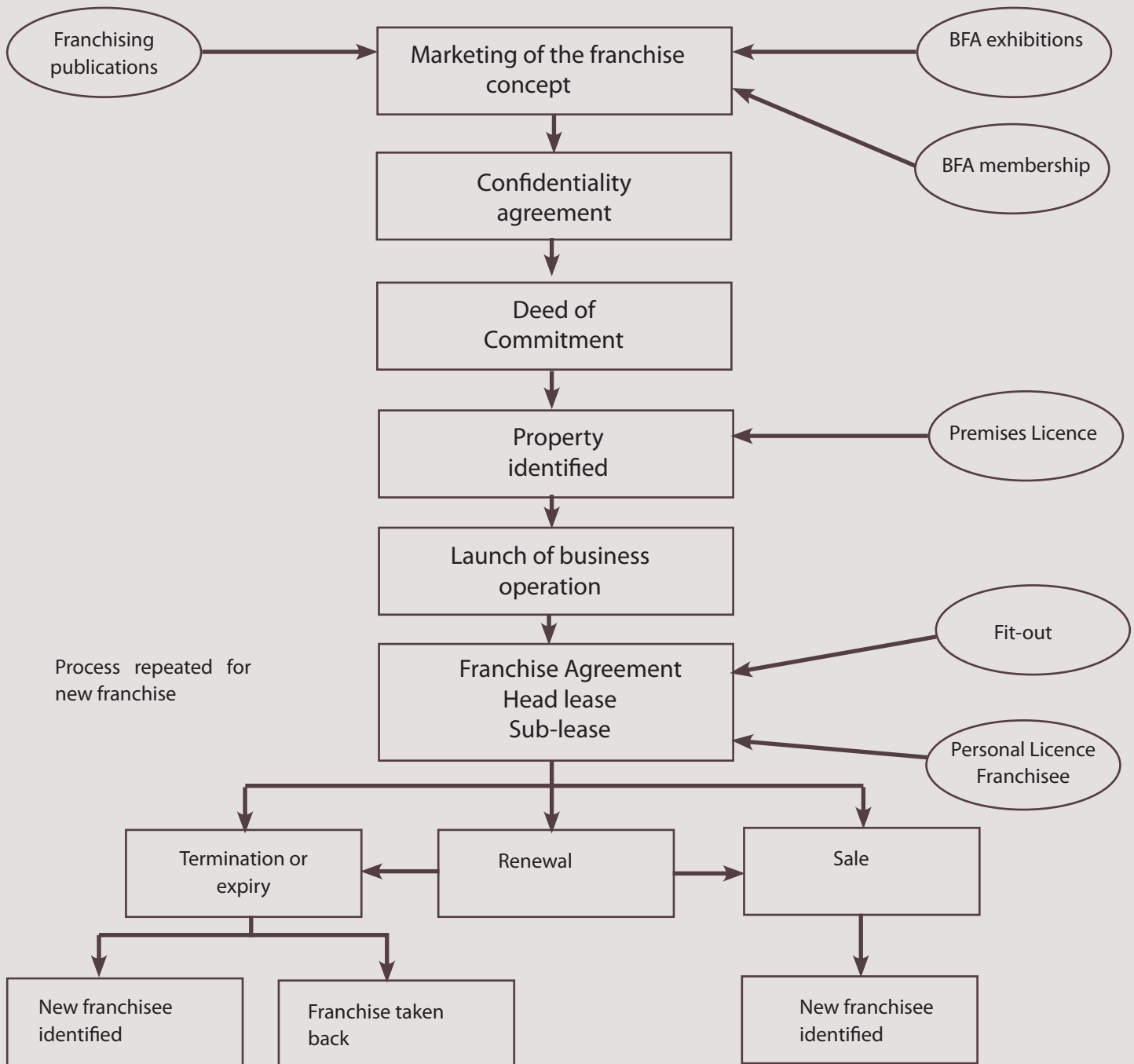


Figure 2: The franchise process



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law@lindermysers.co.uk
www.lindermysers.co.uk