Frequently Asked Questions About Franchising and Other Business Models

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With the right concept, franchising can be an excellent way to grow a business. Developing a solid franchise concept hinges on several factors and requires knowledgeable attention to detail. The upfront strategies you put in place will affect your business and your personal success for many years to come. It's worth the time and diligence to do it right.

The franchise attorneys at Kirton McConkie have outlined questions they are frequently asked when a business owner or a company's senior management is contemplating ways to expand a business. Often franchising comes to mind, but there are other business structures, including licensing, distribution agreements, direct sales and business opportunities.

Consult an attorney specializing in franchising to help you navigate the process from start to finish, including insights into initial business concept strategies, franchise basics, intellectual property protection, franchisor/franchisee relationship structure and direction on state and federal compliance issues.

What is a franchise?

A franchise is a business model a company uses to distribute its products or services through third-party operators. The business owner, or franchisor, establishes business practices such as operations and marketing and provides trademarked products or services.

In exchange, the third-party, or franchisee, pays the franchisor an initial fee and ongoing royalties. In essence, the franchisor grants the franchisee the right to operate under the franchised business name.

There are three main elements the Federal Trade Commission (FTC) uses to define a franchise:

1) The seller promises to provide a trademark or other commercial symbol.
2) The seller promises to exercise significant control or provide significant assistance in areas such as, but not limited to, the franchisee's business organization, management, marketing plan, promotional activities or business affairs.
3) The seller requires payment (at least $500 in the first 6 months of operation).

The more a franchisee relies on the franchisor's control or assistance, the more likely the FTC will find the control significant, which means the franchisor must comply with franchising regulations.

The types of significant control or assistance include:

- Providing formal sales, repair or business training programs.
- Establishing accounting systems.
- Furnishing management, marketing or personnel advice.
- Selecting site locations.
- Furnishing a detailed operating manual.

The third element in the FTC franchise definition relates to payment. What qualifies as “payment” can include up front inventory, fees for services, royalties and goods sold to the franchisee.

Almost any type of business can be a franchise. Some of the most popular categories are automotive, cleaning and maintenance, health and fitness, financial services, pet products and services, fast food restaurants, and hotels.

A franchisor can create a variety of business relationships with its franchisees, including single units, multiple units, master franchise and area development. A master franchise means a franchisor is allowed to sub-franchise units within a defined territory. An area development relationship is similar to a multiple unit owner, but a larger geographic area is carved out for a pre-determined number of units.

When should I consider franchising my business?

If you’re interested in expansion and have a business concept that can be duplicated and standardized, then you may be a good candidate to start a franchise. Once you get past this litmus test, there are other areas to consider when determining whether you can successfully launch a franchise. These include:

- Having a capital reserve to launch the business model that can cover new expenses for accounting, legal and marketing counsel. If structured correctly, the amount you’ll need may be less than the capital you would need to expand your business on your own because the franchisees provide much of the ongoing capital.
- Having a top-notch management team in place to operate your existing business while you concentrate on launching and operating the franchise system.
- Investing in training and support programs and materials for franchisees.
- Creating a profile for an ideal franchisee (and sticking to it).

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What do I need to know about franchise law?

There are individual state and federal laws with which you need to comply. Franchise law is actually a complex collection of federal and state regulations covering franchise disclosure and registration documents. In addition, there are issues related to intellectual property, employment, anti-trust and other laws.

To understand and, more importantly, comply with all the laws related to your franchise, you'll need a legal advisor who specializes in franchise law. An experienced franchise attorney can offer insights and guidance from the fundamentals of franchising to the complexities of compliance.

When you begin the franchising process you'll hear the term Franchise Disclosure Document (FDD). This was formerly referred to as the Uniform Franchise Offering Circular (UFOC). The content is regulated by the FTC and includes over 20 pieces of information to fully disclose to prospective franchisees to help them make an informed buying decision. Currently, 14 states require the FDD be registered in the state. States requiring registration are: California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington, Wisconsin.

What are the advantages of franchising?

The franchising concept saw explosive growth in the 1950s through the 1970s and remains a viable and lucrative way to expand a business. There are major advantages to franchising such as allowing you to spread the capital risk of expansion across franchisees, fueling faster expansion, and creating quicker and broader awareness of your brand.

What are the disadvantages?

As a franchisor, you need to control your business concept. By virtue of selling units to franchisees, however, you will inevitably lose some control and franchisees that don't adhere to your operating policies may damage your brand name. You must also strictly comply with federal and state laws that regulate franchises. Some business concepts may better lend themselves to more limited licensing, business opportunities, joint ventures, or distribution agreements, thereby carefully avoiding the regulations under which franchises fall.

Are there alternatives to franchising?

Yes, there are alternatives to franchising, depending on your business concept. Some business concepts may be better suited to corporate ownership, direct sales or limited licensing.

The franchise attorneys at Kirton & McConkie can help you navigate these alternatives to create a structure that will help your business thrive.

What if I only have one or two potential franchisees in a particular state?

Certain states allow for exemptions to franchise laws if the franchisor only plans to open one or two locations within a specified time period (usually one or two years). If your plan is aggressive growth, we do not recommend availing yourself of these exemptions. The franchise attorneys at Kirton & McConkie can assist you in determining whether these limited exemptions are right for you.

What should I charge for an initial payment and ongoing royalty fees?

As the legal paperwork gets underway, there are decisions you need to make about your business model. These include the upfront franchise fee and royalty fees you'll charge, the term of the franchise agreement, the territory size and number of units allowed within a geographical area.

You should structure your upfront fee to cover such items as initial training, legal expenses and initial supplies. Your ongoing royalty fee should be enough to cover the cost of office expenses, ongoing franchisee management, legal costs, continuing support, and your profit.

Seriously consider the amounts you choose and seek counsel from an experienced franchise lawyer on different payment scenarios. While the difference between a four percent and five percent royalty may seem inconsequential at the beginning, over the years it can result in millions in lost revenue.

The fees you charge must cover the basics and, of course, deliver a healthy profit, while still allowing franchisees to prosper.

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How can I best protect my ideas and business concept once I franchise?

The intellectual property for your business is comprised of the unique concept, logo, company name and other elements, which will all need legal protection. The most powerful protection is calling upon trade or service mark, copyright, patent, trade dress, or trade secret laws. If you plan to expand outside the United States, you'll have to consider all of this on an international basis.

Seeking the counsel of an experienced franchise law attorney is the best way to protect your business and your brand. Take this precaution before you introduce the idea of franchising to friends, family or business acquaintances.

To what extent do I need to support and train franchisees?

The more resources you provide franchisees to enhance their success and maintain consistency for your brand, the more success you will realize. Delivering comprehensive support and training are essential. By the time you structure your franchise concept, get the necessary legal documentation drafted and filed and sell to franchisees, you will have invested a substantial amount of time, energy and money. You can't afford to skimp on support services. In fact, franchisees expect initial and ongoing training in exchange for their upfront fees and continuing royalty payments.

The support you provide and the training you implement will instill a quality control process at the unit level and will create uniform methods of service. Customers should have the same expectations and experiences, regardless of the franchisee unit they visit.

How hard is it to expand into other countries?

Some countries have adopted U.S.-type regulations and others rely on general consumer protection laws to regulate franchises. In either case, there are country-specific requirements to which you must comply. Kirton & McConkie attorneys have extensive experience throughout the world and are happy to help structure your international, as well as your domestic, operations.

For more information

Have questions? Contact the attorneys at Kirton McConkie at (801) 328-3600 or via email at:

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