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Small & Medium Enterprises General Authority

Franchise for the Franchisee

Contents

Definition of Franchise

Franchise is a contract between two parties where the first party (franchisor) grants the second party (franchisee) the permission to use one or more intellectual, industrial, or knowledge-based property rights to produce goods, distribute products, or provide services under a brand created by the franchisor. This agreement is limited to a specific geographical area and a defined period of time, in exchange for a financial consideration paid by the franchisee to the franchisor.

Franchise is an important investment tool. Instead of starting a business from scratch, investment companies seek successful projects that have franchising rights and open these projects in areas where the brand has not yet reached. However, before making any investment decisions, it's important to understand some key terms and phrases related to the franchise industry:

Franchise

A franchise is a business model in which a franchisor grants a franchisee the right to conduct business under their trademark or trade name. The franchisor provides the franchisee with technical expertise and knowledge, as well as operational methods, in exchange for financial or non-financial consideration. This may include ongoing fees paid by the franchisee to the franchisor, but does not include the amounts paid for goods or services.

Franchisor

An individual or legal entity that grants the franchise under the franchise agreement. The franchisor can be either the primary or sub-franchisor, depending on their relationship with the franchise.

Franchisee

An individual or legal entity that is granted the franchise under the franchise agreement. This includes the sub-franchisee in relation to their relationship with the primary franchisee.

Franchise Model:

The process followed to manage the franchise as determined by the franchisor. This includes the presentation of the associated brand, which the franchisee must adhere to.

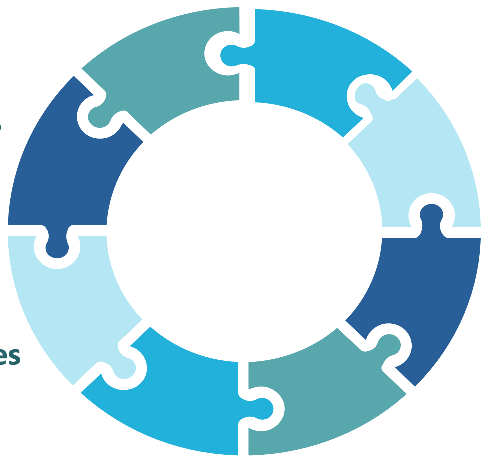
Definition of Franchise

If you're considering investing in a franchise, it's important to understand that you will need to demonstrate your ability to manage the business to the franchisor and market the products or services offered.

Before agreeing to purchase a franchise, it's important to carefully study every franchise offer from the franchisor. Some of the key points that should be considered include:

- **Contract term:** The term is determined by the nature of the granted franchise right and the amount required to invest.
- **Capital:** Franchise offers that require capital.
- **Marketing fees:** The franchisor usually asks franchisees to contribute a specific percentage of their total sales to the marketing fund to develop sales locally or globally.
- **Administrative fees:** This is the percentage of monthly or quarterly sales paid by the franchisee to the franchisor under the franchise system.
- **Initial fees (entry fees):** This is a one-time or several payments made as financial compensation to the franchisor for using their intellectual property rights, initial training, and administrative expenses for using the franchise.
- **Number of branches:** Determining the number of branches if the franchise is the "main franchise."

Elements of a Successful Franchise



Elements of a Successful Franchise

When considering obtaining a franchise, there are several key elements that should be carefully evaluated:

Successful Brand:

Many business owners who purchase franchise rights for promising brands face many problems after a period of time. Therefore, you should study the market and research successful brands in addition to obtaining as much information as possible, while making sure there are no legal issues or disputes between franchisors and their customers.

Obtaining Financing:

Purchasing franchise rights is not a low-cost project, as the franchisee must take care of several matters such as rent, salaries, operating costs, maintenance, invoices, and paying franchise fees.

Building a Strong Team:

The success of a franchise largely depends on the strength of the team. It is crucial to recruit and hire individuals who share the franchise's vision and possess the necessary skills and experience to help the franchise grow and thrive.

Working Hard:

Your role as a franchisee is not limited to paying the required fees, renting a specific location, and hiring employees. Rather, you are responsible for maintaining the brand identity and marketing it, increasing customer loyalty and satisfaction, increasing sales, and ensuring its continuity.

Franchise Fees:

Determining the fees that the franchisee will pay to the franchisor, as well as determining the payment method and style, is one of the most important provisions of the agreement. In addition, knowing the fees that must be paid is one of the most important things that the franchisee must examine and take into account before deciding to purchase the franchise. There are many ways to collect or pay these fees, as they can take the form of immediate cash payment or continuous and multiple cash payments, or include both types.

Franchise Fees

Are there specific fees for franchise rights?

There are no set fees for franchise rights. Each franchise has specific fees based on its industry, number of branches, products or services, and other factors. These fees are outlined in the franchise agreement. The fees include the amount paid to the franchisor for the right to use the franchise, annual fees for the use of trademarks, operating methods, and distribution rights owned by the franchisor. Other fees may include advertising and marketing costs, monthly fees which are often a percentage of sales, and the requirement for the franchisee to purchase or lease equipment and supplies from the franchisor. Some franchisors may also require the franchisee to cover training costs.

Types of franchise fees paid to the franchisor:

First: Franchise Fees (Initial Fees)

These are financial compensation paid to the franchisor for granting the franchisee the right to use the franchisor's intellectual property, or for initial training and administrative expenses associated with establishing a new franchise location.

Second: Main Franchise Fees

These are paid by the franchisee to the franchisor in exchange for the following rights: the use of the franchisor's intellectual property, the use of technical knowledge and expertise, the right to sell products and services, and the right to establish a successful business similar to the franchisor's business in the host country. These fees also cover the use of the franchisor's specific market, which is made available to the franchisee for qualified and trained investors who have been approved by the franchisor. These fees include initial and ongoing training, equipment, materials, goods, and advertising programs.

Third: License Fees:

These are specific fees paid in exchange for the right to use the franchisor's intellectual property rights, technical knowledge and expertise, the potential of the market in the region, and other costs incurred by the franchisor. These fees are included in the franchise fees.

Franchise Fees

Fourth: Marketing Contribution Fees

These are ongoing fees paid by the franchisee to the franchisor as a contribution to the cost of providing marketing support, advertising, and promotion. They are calculated as a percentage of the total sales generated by the franchisee.

Fifth: Advertising and Promotion Fees

These are regular fees paid by the franchisee to the franchisor as a contribution to the cost of providing marketing support, joint advertising, and promotion programs. They are calculated as a percentage of the total sales generated by the franchisee.

Sixth: Opening Fees

These are fees payable for the establishment of each additional store, according to the terms and conditions of the franchise agreement.

Seventh: Royalty Fees (or Franchise Package Fees)

A percentage of the total gross sales revenue generated by the franchisee, payable to the franchisor for ongoing administrative and operational support provided during the term of the franchise agreement.

Eighth: Fees for Specific Services

Fees for specific and defined services agreed upon by the parties. These services generally fall under the responsibility of the franchisor, as it is their duty to provide constant advice and expertise to the franchisee to ensure the success of the brand. Accordingly, the franchisor also receives fees for these specific services, consultations, and expertise, which are agreed upon and outlined in the contract.

Administrative Fees:

There are two methods for calculating administrative fees:

1. Flat amount:
Some franchisors may require a fixed amount to be paid at the end of each month. This method is suitable for calculating administrative fees, and in some cases, administrative fees must be a percentage proportionate to sales. The fixed amount method has its advantages and disadvantages and is more suitable when the size of the franchise is small.

Franchise Fees

2. Percentage of sales:t

This is the prevailing and usually the best method, where fees are calculated as a percentage of the sales volume achieved. This percentage varies depending on the importance of the services provided. Some franchisors may impose a minimum guaranteed percentage, such as %5. In this case, the franchisee must keep sales records and accounts according to the agreed-upon standards.

Marketing Fees:

Why are franchisees required to pay marketing fees?

Since the franchisee benefits from the distinctive brand and good reputation of the franchisor, it is common for the franchisor to charge separate fees for the promotion and advertising of the franchise system. The franchisor determines this value in the franchise agreement, taking into account the necessary costs for organizing a promotional campaign at the local or country level, as well as the costs of producing enough promotional materials. The joint marketing fund also finances public relations activities for the franchise system.

Franchise systems do not typically charge fees for the joint marketing fund at the beginning of their operations. This continues until sufficient financial resources are collected from the largest number of franchisees to begin suitable advertising campaigns for the franchise system.

How does the franchisor manage marketing fees?

Generally, companies allocate a separate bank account for marketing fees. For example, if the franchisor has 100 branches in four different countries, and each franchisee pays %2 of their sales at the end of each month or on a quarterly basis, these amounts are transferred to the marketing account. The franchisor is not allowed to use or borrow from this amount, and the account is only used for franchise marketing activities.

Some transparent large companies may appoint a separate financial auditing company to audit this account and issue a quarterly or annual report that is published and sent to all franchisees to reassure them about the handling and disbursement mechanism of these amounts.

Franchise Fees

How to pay marketing fees:

- **A flat amount**
- **A percentage**
- **A specific amount for a certain period**

The franchisee must study the financial offer and read the profit and loss statement, which can be obtained from the franchisor. Usually, this statement is in an Excel file that shows all the numbers, so it is necessary to ask the franchisor whether the numbers are realistic or ideal.

If the profit and loss statement given is just an ideal model, the franchisee can measure it against the area where they operate and put the numbers that correspond to their area. The franchisee has the right to obtain the following:

01 **The profit and loss statement in realistic numbers**

02 **Visit other franchisee branches and communicate with them to ensure the accuracy of the numbers in the profit and loss statement**

03 **Obtain contact information for other franchisees from the franchisor**

Factors not apparent in the financial offer:

Some information is not found in the financial offer or the profit and loss statement, but it must be taken into consideration, such as:

The nature of the product consumer:

It is undoubtedly true that the nature of the consumer affects sales forecasting, and their nature varies according to a set of criteria related to personality, social environment, cultural influences, and economic factors in the society. These criteria include: the level of culture, social class, personal beliefs and aspirations, occupation and income, age, gender, profession, purchasing habits, and geographic location.

Franchise Fees

The cost of human resources:

The cost and laws of human resources differ between countries, so when taking into account the profit and loss statement or structuring employees, it is necessary to apply it to the area where the project will be opened and consider the differences in cost and laws. The number of employees and the cost may differ, and therefore the salary structure will also differ from what is given in the profit and loss statement received from the franchisor.

There is also a process known as localization, which involves adapting external information to fit the city or region where it is located. This can be achieved by changing currency, restructuring human resources, or adjusting the costs of raw materials and other expenses.

Sales volume:

How do you know the daily or monthly sales volume?

The franchisee must understand the nature of the demand for the product or service they offer and consider three factors:

1. Is the product well-known in the market or new?
2. Is demand for the product independent or derivative?
3. What is the nature of the product consumer?

Derivative	Independent
Depends on another product	The product is in demand by itself
Tends to fluctuate	Tends to be stable
Forecasting the demand for the original product is needed	Sales forecasting is direct

Franchise Fees

Methods for predicting sales volume:

01 Personal judgment and salespeople's opinions

02 Comparison with the sales volume of similar projects

03 Statistical methods for sales forecasting

04 Pre-orders/purchase requests

General Information for Evaluating the Franchise Opportunity

You should find the following financial information in the franchise opportunity you have chosen, and determine its potential return on investment and its compatibility with your abilities and aspirations:

01 What will you pay to obtain the franchise?

02 What industry aligns with your interests and abilities?

03 What is the profit and loss statement provided by the franchisor?

04 What is the projected growth rate that will attract customers?

After considering the previous criteria, here are the franchisor-specific criteria that you should investigate to ensure your rights:

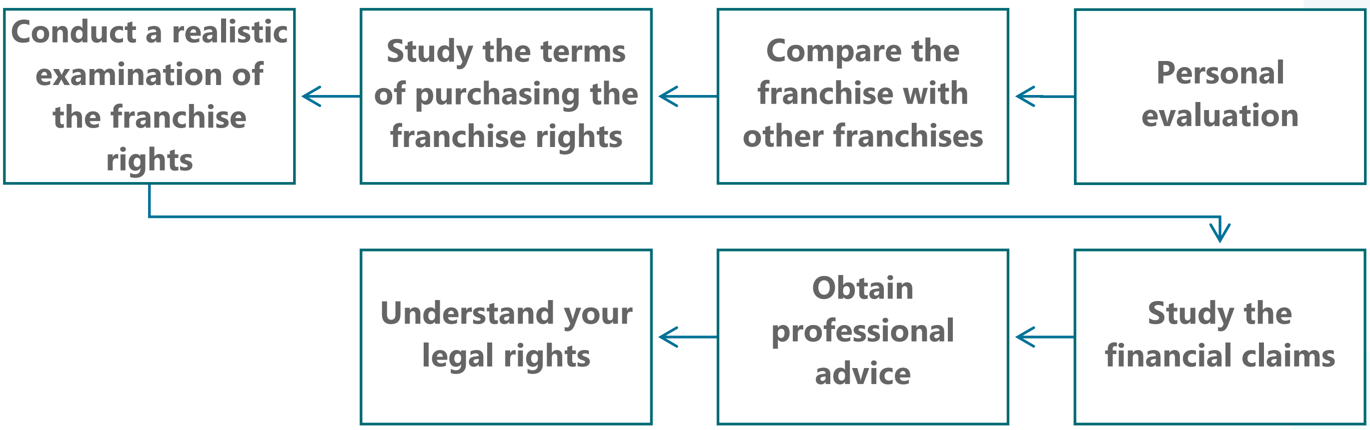
- What is the franchisor's definition of the opportunity? What are its aspects? What are your rights and responsibilities?
- What are the complete resumes of the top management of the franchisor?
- How many franchisor units are there?
- What is the legal status of the franchisor?
- What are the required disclosure documents?
- What are the locations and territories in which you can operate?
- What are the start and end dates of the franchise agreement?
- How well does the franchisor's brand definition align with reality?

General Information for Evaluating the Franchise Opportunity

Other investors' criteria:

- **You should obtain a list of the other investors (franchisees)**
- **The geographic area of each franchisee to determine the level of competition**
- **Avoid the problems that the franchisor may have with other investors**

Seven steps that an investor can take to protect themselves when entering or considering purchasing franchise rights:



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