

The Most Common Mistakes in International Franchising

Mistake No. 1: The “Low Risk, No Risk” Approach

To their everlasting regret, a number of American franchisors have approached international franchising on a “low risk, no risk” approach. They have mistakenly believed that they can pocket a franchise fee and draft a master license agreement that shifts all the burdens and risks to the franchisee. While theoretically possible, the practical results are different.

A former restaurant client tried this approach in Asia on the premise, “What have we got to lose?” An arms-length contract shifted all obligations to the franchisee, and required the franchisor to provide nothing but a license, training in the United States, and one on-site opening crew for the first unit in Asia. The training and the opening crew taxed the franchisor’s system, but were manageable. The poor performance, constant complaints, and problems raised by the franchisee were more troublesome.

Ultimately, despite a lopsided contract drafted to protect the franchisor, the franchisee sought arbitration, and ultimately filed suit in US Federal Court. Five years of rancor, and over \$2.5 million in attorney’s fees later, the case settled during the second week of an anticipated five week jury trial. So much for “low risk, no risk.”

Mistake No. 2: Let’s open in Lithuania

There’s nothing inherently wrong with Lithuania. I use it here as a metaphor for a classic franchisor international expansion mistake: opportunism versus planning. While I was discussing international franchise expansion mistakes with a colleague, he noted that a client of his had opened their first international unit in Lithuania. When he asked the client what research supported choosing Lithuania as their first overseas location, he was told, “nothing, but this guy showed up with a check.”

Personal experience and a study by Anderson Consulting and the IFA several years ago support the fact that the vast majority of American franchisors use opportunism versus planning. Basically, they have no international plans, but are contacted by an ex-patriot or company looking to buy a franchise. The problem with this approach is that a franchisor may quickly find themselves with a hodgepodge of difficult to service franchises scattered from Korea and Japan to Dubai (a real life example of one client). Or, Hong Kong and Mexico (another real life example).

Unfortunately, many of these opportunistic expansion plans turn into nothing more than junkets for senior executives and their spouses. The American franchisor may not be ready to sell, service and manage a franchise overseas. And, if it’s not ready, it should resist the opportunity. Or, it may regret having to fly to Lithuania.

Mistake No. 3: Let's give them Western Europe

Granting too large a territory is a common problem. Most franchisors expand through master license, or some type of territorial license agreement. As with any market, the price of the territory, and the territory size itself, should be determined by what the system can support and what can be reasonably penetrated in a reasonable amount of time. Granting too large a territory ensures that it will never be fully exploited, and that the system will never expand to its full potential. If a master licensee struggles, then a large chunk of territory may be tied up for years before the licensee either recovers or is terminated.

One client learned as it went along, and its international territories became smaller and smaller with each successive agreement. But, when it was learning, a senior executive was heard to say, while looking at a map, "let's give them everything between Switzerland and Spain." This encompassed Belgium, the Netherlands, Luxembourg ("Benelux"), Switzerland itself (a territory with four languages), and, of course France. As time went on, the Benelux nations and Switzerland lay fallow, while the master franchisee successfully developed France. The company often received franchise solicitations for the other territories, but had to decline because they were already granted.

Fortunately for the Franchisor, the French franchisee was unusually enlightened, and realized that he and the system would benefit most from a fully developed territory. He willingly gave up the excess territory (at cost) so that it could be developed.

I have seen huge swaths of Asia, and the entire Middle East granted to franchisees in one fell swoop. A little research will help determine the population that is viable for the franchisor's goods or services, and how much territory there needs to be to support a master licensee. Granting anything more than the minimum simply ensures slower development. The best response to a franchisee who wants a larger territory is: "let's start small, and once you've developed that, we'll talk."

Mistake No. 4: We're protected, they have to sue us in the U.S.

No, they don't. Many franchisors save money by having an inexperienced attorney adapt their U.S. franchise agreement for international deals. The attorney and franchisor feel they've protected themselves when they insist on U.S. law and venue. Later, they may both learn a painful lesson about trying to enforce US judgments in foreign courts, or they may find themselves trying to defeat venue and jurisdiction in a foreign court. They may find that some nations don't recognize these provisions, or that simple provisions of the contract are unenforceable under the laws of the host country.

I have always budgeted \$15,000-25,000 in legal fees to ensure that a contract is adapted for the laws of the country where the franchise will be located, is enforceable in that country, and that my client's marks and systems can be protected in that country. Beyond the countries that have active franchise laws (which need to be followed), there

are tax treaties to review, licensing and tax laws to follow, and of course, marks to be registered and protected. At the end of the day, unless the contract can be enforced, and the marks protected in the host territory, drafting an agreement with U.S. law and venue will provide illusory security.

Mistake No. 5: Grafting the International Program onto Domestic Operations

If you want to do something well, you should do it right from the beginning. In international franchising that means planning and developing the internal resources to support international expansion. Simply grafting the international franchise program onto existing operations, or onto the domestic franchise sales program, may not work.

As one client learned, there are problems. For example, Restaurant Managers from Asia don't have credit cards and often can't drive. (Try getting around in Southern California without a credit card or a license.) Without a well-thought out training program and housing plan, the client found that the franchise employees from Asia had trouble adapting and learning during their several week stay in the U.S.

Another problem is the translation of certain materials. Unsupervised translation of materials ensures that a lot gets lost. Distance increases the risk of "tropicalization" of the concept. A certain way to get off to a bad start is to shift the burden of translating all materials to the franchisee without any supervision.

The range of sensitivity toward foreign licensees may vary dramatically in the employees borrowed from the corporate or domestic side. Without a clear focus and understanding about what the international franchisee is supposed to do (same as domestic? Different? Change everything? Change nothing?) the grafting of international servicing onto harried domestic employees usually won't take.

Mistake No. 6 Know Your Partner—No Vegetarians in Hamburger QSR's

A franchisee must understand the franchisor's goals and quality standards, and must themselves have their own, long-term, high-quality business goals. A shared philosophy between franchisor and franchisee may be even more important in the long run than capitalization or money.

A hamburger QSR client sold franchise rights in Asia to a wealthy group from an obscure Indian Sikh sub-set. They were strict vegetarians. Although wealthy, "they couldn't even taste the food," complained one executive in trying to understand their consistently poor operations. The other problem was that they were real estate investors, not restaurant operators. Their personal and professional goals and abilities were not in sync with the franchisor.

I have interviewed and rejected franchise applicants whose primary goal was a quick buck and an exit strategy. They clearly didn't understand the work and commitment involved in building operations from scratch in an international market.

Conclusion

International franchising can be successful. But, like every other business endeavor, it must be planned, not haphazard, it must be supported with resources, and, like every other business endeavor, it will have risks. No matter how you draft the contract.

About the author

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