

Meaning, Parties involved, obligations, kinds of fees Payable, Term of Franchise, Termination

Franchise Accounting

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Franchising is a system of business acquisition

Now a days buying existing business is as common as starting from scratch. Buying business through Franchise contracts has become quite common. But entrepreneurs are persons who start a new venture, and do not buy an existing one. Franchising is unique approach to business that originated in USA and has spread throughout the world. So Franchising is one of the methods to start a business.

Meaning of Franchise :

A Franchise is a business opportunity where by the owner (producer or distributor) of service or Trade Marketed Product, grants exclusive rights to an individual for the local sale of the service or product in exchange for royalty of share of profits

In other words, a "Franchise" is an agreement between two parties which allows one party i.e. the Franchisee to market product or services using the trademark and operating methods of other party i.e. the Franchisor

Franchise:

The person who buys the right is called the Franchisee

In short Buyer is called Franchisee

The company who sells rights to its business is called the Franchisor

Franchise Agreement :

(The contract between Franchisee and Franchisor is called Franchise Agreement.)

FRANCHISEE

Parties Involved in Franchise :

In franchise business two parties are involved viz.,

- 1) Franchisor and
- 2) Franchisee.

Meaning of Franchisor and Franchisee :

An individual or business that grants the right to the other to sell the product or service is called as 'Franchisor' while the beneficiary of the right is called as 'Franchisee'.

In other words, a person or company that grants the licence to third party for conducting of business under their brand name is called 'Franchisor' and to whom licence is granted to do the business is called as 'Franchisee'.

Obligations of Franchisor and Franchisee :

The success of franchise business depends on the good relationship between franchisor and franchisee. Both the parties have important obligations too and they must handle these obligations to keep the business intact. As per franchise agreement both the franchisor and franchisee has some key obligations as shown below :

Franchisor Obligations :

1. Obligation to provide advice on :
 - a) Finding good premises and alternations to the premises
 - b) Procedure to set up the franchise
 - c) Procuring the equipment, stock etc., as set out in the schedule
 - d) PR (Public Relation) Launch
 - e) Initial training programme
 - f) Operations manual on loan to franchisee.
2. Obligation to provide franchisee with know how, advice and guidance relating to the business.
3. Obligation to supply products to the franchise.
4. Obligation to supply stationery when required.
5. Obligation to train franchisee's staff.
6. Obligation to organise an annual conference for franchisees.
7. Obligation to improve the system through the use of research and technological advancements.
8. Obligation to protect brand and trade mark.

Obligation of Franchisee :

1. Obligation to renovate and equip the premises as required by franchisor.

Types of Franchises :

There are three main types of franchise opportunities available in the business field :

- 1. Product distribution franchise :** Under this type of franchise, a product manufactured by the franchisor (or on his behalf by another) is sold to a franchisee who in turn sells it to the consumer under the trademark of the franchisor. This type of franchise is usually restricted to a particular geographical area and the franchisee pays fees as royalty to the franchisor for right to do business under trademark and brand name. It focusses on individuals who are selling products or delivering services in specific trade or

industry field. This type of franchise is most suitable to those who are first time business owners, independent contractors and home business since the investment needed is usually smaller compared to other types of franchises.

2. **Manufacturing, production or processing franchise :** Under this type of franchise the franchisor sells to the franchise an essential ingredient or provides some specific know-how which along with ongoing quality controls by the franchisor which enables the franchisee to manufacture/produce/process the final product and sell to the consumer. Generally franchisor allows a franchisee to produce items using their brand name and trademark. This type of franchise is the most popular among food and drink (soft) companies.

3. **Business format franchising :** Under this type of franchise, franchisor grant the licence to the franchisee to use the particular business model including intellectual property associated with it i.e., trademark. This franchising is the most widely used form of franchising where franchisor controls the business and managed by the franchisee. The franchisor provides training, mentoring and assistance to the franchisee. The franchisee makes both initial and periodic payments to the franchisor. This type of franchising facilitates the expansion of the franchisor business by allowing individuals to buy business with an established brand name. The best example of this franchise model can be found in the fast-food industry.

Franchisee Fees :

A franchise fee is a fee that a person (franchisee) pays to operate a franchise branch of a larger company (franchisor) and enjoy the profits there from.

Kinds of Fees Payable :

Generally there are three kinds of fees payable by franchisee to franchisor.

1) **An Initial Fee :** It is an up front lumpsum fee payable by franchisee to the franchisor. It is also called as franchise fees. It is paid by franchisee to the franchisor to become a franchisee. It varies based on territory size, experience or other factors. Many franchisors offer fee discounts for veterans, minorities or existing franchisees.

2. **Royalty Fees :** Royalty is fee paid on regular basis (weekly, monthly or yearly) on the basis of sales made in some percentage. It is also called as 'on going fees'.

3. **One off Fees :** Various fees like renewal fees, advertising fees, administration fees, etc., payable by franchisee to the franchisor is called as 'one off fees'.

Term of Franchise :

It is the length of time that franchise agreement is valid. Usually an initial period of agreement is 5 years with the right to renew. If it is found that franchisee in good standing, franchisor will allow him to renew the agreement.

Termination of Franchisee Agreement :

The franchisor may terminate the franchise agreement if the franchisee :

1. Fails to commence business within three months of execution of the agreement.
2. Breach the specific terms and conditions mentioned in the agreement.
3. Found to have supplied materially false or misleading information.
4. Goes into liquidation/bankruptcy/insolvency.

5. Convicted of a crime.
6. Fails to pay royalties.
7. Fails to correct defaults after notice.
8. Fails to comply with required business operations.

The franchisee can also terminate the agreement if a franchisor :

1. Fails to provide training and support as mentioned in the agreement.
2. Commits fraud or misrepresents the potential profits.
3. Fails to protect the franchisee's business opportunity or territory.
4. Goes bankrupt/becomes insolvent.

After Terminating Franchise Agreement :

After termination of the franchise agreement, the franchisee must :

1. Stop using the franchisor's trade name, trademarks and service marks.
2. Agree to a covenant not to compete or a No Complete Clause.
3. Pay all outstanding amounts due.
4. Return franchisor's manuals.
5. Agree not to use trade secrets.

QUESTIONS

Short Answer Types Questions of 2 Marks Each :

1. What is franchise ?
2. Name the parties involved in franchise.
3. Write any four features of franchise.
4. Write any two advantages of franchise to franchisor.
5. Write any two advantages of franchise to franchisee.
6. Write any two disadvantages of franchise to franchisor franchisee.

7. What are the types of franchises ?
8. What is business format franchising ?
9. What are the kinds of fees payable ?
10. What is the minimum term of franchise business ?

Long Answer Type Questions of 5 Marks Each :

1. Explain the features of franchise business.
2. Explain the advantages of franchise business to franchisor.
3. Explain the advantages of franchise business to the franchisee.
4. Explain the franchisor's obligations.
5. Write the obligations of franchisee.
6. Explain the types of franchises.
7. Write a note on franchise fees.
8. When franchise agreement can terminate ?