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Tutorial 1: What is a Franchise?

Franchising is a business relationship where a franchisor (a company or individual who owns the franchise system) grants a franchisee (a company or person who contracts to use the franchise system) the licence to use the franchisor’s trademark, brand and operating system for an initial fee (initial franchise fee). In return, the franchisee provides a share of the income back to the franchisor (a royalty). The licence is contractual and is usually for a fixed period of time, often five, 10, or 20 years. The franchisor selects candidates to become strategic-partners in implementing the business plan and selling products and services to the franchisor’s customers using the franchisor’s proven business model and/or their proprietary products. A franchise system has policies and procedures in place so as to create consistency from one franchise location to the other.

As a growth strategy, it provides franchisors with the ability to gain market share by increasing their points of distribution. Increased points of distribution result in greater exposure and brand awareness. Franchisors are able to grow and have committed individuals operating and driving the location. From a franchisee perspective, it allows the franchisee to get into business with support, a brand name, and a proven business model. This helps to reduce the risks involved with getting into business.

It has become a part of almost every industry. Although people most often think of fast food when they think of franchising, it is also found in many other sectors including retail, service, automotive, business services, real estate, and lodging.

There are several things that one must understand about a franchise. You are not buying the franchise. Instead, you are acquiring a licence to operate a franchise. You do not own the name, but instead have a licence to use the name. You do not own the business model, but instead have the rights to use the business model for a period of time. It is a little like being a tenant and renting. You do not own the space you are renting, but instead have the use of the space for a period of time.

Uniformity is a fundamental principal to the success of a franchise. There must be consistency from franchise to franchise within a given business. By having the same product in similar outlets, with consistent levels of service, the franchise is able to build confidence in the mind of the customer, and

**Franchising provides numerous benefits:**
- An established brand and proven business model
- Mass purchasing power
- Co–operative advertising
- Operational support and training
- R&D, marketing new products and services
- Access to financing and site selection

**Hallmarks of a strong franchise include:**
- Strong leadership
- Participative management with Franchise Advisory Councils enhancing communication
- Continuous training
- Evolving brand development
- Continuous improvement to the operating system
- A positive corporate culture
this drives people to the brand. Customers gravitate to what they know, what is familiar, and what they trust. The uniformity is often created through operating standards and procedures that are clearly documented in operation manuals. Franchisees are required to follow an operating system, use the same suppliers of product, and take the same training. The system, suppliers, and training are all designed to create a consistent experience to the end user of the product or service, and thus create an expectation and impression in the mind of the customer.

The uniformity is enforced through a franchise licence. This licence gives you the right to use the brand and operating system. The licence also comes with obligations, to follow the operating standards and systems, as clearly defined in the business model. If you fail to follow the standards, you may lose your licence. With compliance to the system, it drives the market and enhances your investment. When you first look at a franchise agreement, it may seem controlling and one-sided in favour of the franchisor. This is normal, and is required to allow the franchisor to control the integrity of the brand. As a franchisee, it is important to understand that you are required to conform to the franchise system business model. The success of the system as a whole to build a brand is dependent upon consistency.

Although you cannot simply do what you want, strong franchise organizations value franchisee input and often create advisory groups to provide feedback and input to the franchisor to assist in the strategic direction of the company. They view the franchisee and franchisor relationship as a partnership. Franchisees are on the front lines and have strong knowledge of the needs of the customer. At McDonald’s, it was the franchisees’ input that led to the development of the Egg McMuffin® and the McFish® sandwich. Strong franchisors listen and value the input from franchisees.

**Study Questions**

**1. From a franchisee perspective, franchising benefits by:**

   a) allowing the franchisee to make money by collecting royalties from the franchisor.
   b) allowing the franchisee to get into business with support, a brand name, and a proven business model from the franchisor.
   c) transferring ownership of the franchise system to the franchisee.

**2. One of the fundamental principles of franchising is:**

   a) uniformity and consistency across all franchise locations.
   b) a lack of consistency in customer experiences from location to location.
   c) complete autonomy of franchise locations from the franchise system.

**3. Franchising only exists in the fast food industry. True or False?**

   a) True  
   b) False

**4. Franchisors often do not welcome franchisee input. True or False?**

   a) True  
   b) False

**Answer Key:** 1) b  2) a  3) b  4) b
Franchise fees are typically paid for the use of the franchisor’s trademark, brand, and operating system. There is usually a one-time initial franchise fee, as well as an ongoing fee, called a royalty. The ongoing royalty may be a flat monthly or weekly fee, or a percentage of the gross sales from the business. In addition, most franchise companies charge a fee for an advertising fund where the advertising dollars of the franchisees are pooled together to allow for franchisees to share the costs of national or regional advertising. By pooling the advertising dollars together, they are able to afford advertising that would not have been affordable otherwise.

**Glossary of Terms**

**Advertising Fund:** A fund held by the franchisor where franchisee advertising dollars are pooled together for national and/or regional advertising.

**Franchise:** The right to use the trademarks, know-how, and business systems of the franchisor, and to promote and market products and/or services using such trademarks, know-how, and systems.

**Franchisee:** The company or person who contracts with the franchisor for the right to operate the franchise in return for payment of an initial fee and/or an ongoing royalty.

**Franchising:** A way of doing business in which the franchisor gives the franchisee the right to offer, sell or distribute goods or services identified by the franchisor’s trademark.

**Franchisor:** The company or individual that owns or controls the trademarks and the franchise system and grants the right to operate the franchise using the trademarks, know-how, and business systems of the franchisor.

**Franchise System:** A system of marketing and distribution in which an independent businessperson, for a fee, is granted the right to market the goods or services of the franchisor according to the established standards and practices of the franchisor.

**Initial Franchise Fee:** A one-time fee paid by the franchisee to the franchisor in payment for the right to operate a franchised business (also known as an Initial, Up-Front, or Licence Fee).

**Franchise Model:** A business model that has in place policies and procedures to create consistency from one franchise location to the other.

**Royalty:** An ongoing fee paid by the franchisee to the franchisor, often calculated as a percentage of sales.

**Trademark:** A name, symbol or other device identifying a product or service of the franchisor that distinguishes them from similar products and services supplied by third parties.
Why Do Some Franchise Systems Have Franchise Fees and Others Do Not?
The initial franchise fee will vary from $5,000 to $75,000+. How much the initial fee is will vary depending upon the amount of training and support that is provided to get the new franchised location up and running. In addition to the initial training and support, the initial franchise fee covers the cost of franchisee recruiting, territory analysis, site identification, grand opening launch, and some recovery of the franchise development costs. Typically, the more established and recognized the brand of the franchisor, the higher the initial fee.

Ongoing royalty fees will vary from 0 per cent to 20 per cent of gross sales. The amount will vary depending upon the level of ongoing support and services that are provided by the franchisors. For example, some franchisors may provide a centralized call centre with order taking. This requires a higher cost, which is addressed with a higher royalty.

Where no royalty is charged, it is usually built into product sales or sale of services in the form of mark-up or rebates on products. Typically, the more involved the franchisor is with ongoing business operations, the higher the fee.

Franchisors must make some form of revenues and profit in order to provide ongoing support and services. A royalty ensures that the franchisor has a vested interest in your success. Your success results in their success.

Study Questions

1. Franchise fees are typically paid:
   a) when first meeting with franchisors. 
   b) every year.
   c) for the use of the franchisor’s trademark, brand, and operating system.

2. Ongoing royalty fees will vary from:
   a) 0 per cent to 20 per cent of gross sales.
   b) 50 per cent to 90 per cent of gross sales.
   c) 60 per cent to 100 per cent of gross sales.

3. An advertising fund is a government funding program to assist franchisors in developing advertising materials. True or False?
   a) True
   b) False

4. A royalty ensures that the franchisor has a vested interest in your success. Your success results in their success. True or False?
   a) True
   b) False
Deposits are often collected by franchisors prior to entering into a full franchise agreement. They are typically a percentage of the initial franchise fee or the full initial franchise fee amount. When entering into a franchise agreement, the deposit is credited towards the amounts owing. Should the potential franchisee choose not to move forward with the agreement, the deposit may or may not be refunded. There is usually a Deposit Agreement that is entered into at the same time the deposit is made. This agreement defines how and if the deposit will be returned, provides timelines, and typically addresses the issue of confidentiality. Deposits are paid prior to entering into a franchise agreement.

The main purpose of the deposit, from the franchisor perspective, is to differentiate the serious candidates from casual enquiries to the franchise opportunity. Franchisors often deal with hundreds of enquiries every month, and simply cannot begin to work at finding locations or assist with bank financing with everyone. A deposit allows franchisors to properly allocate its resources and ensure that there is some compensation in the event that the prospective franchisee does not move forward. The franchisor is also concerned with confidentiality. The deposit agreement will often have clauses stating that the provided proprietary information will be kept confidential and that appropriate materials will be returned.

From a potential franchisee perspective, deposits will often permit one to put a territory on hold so that the potential franchisee can do their due diligence, arrange financing, have documents reviewed by a lawyer, or find an approved location.

By paying a deposit, potential franchisees demonstrate their seriousness in the franchise opportunity and are ensuring that resources are being prudently spent. The franchisor will normally work with potential franchisees to remove conditions on the deposit agreement while reserving the desired territory for a limited period of time.

Deposits can be refundable, partially refundable or non-refundable, depending upon the circumstances and primarily how much time the franchisor spends working with the potential franchisee. The franchisor wants to be compensated for its efforts in, for example, reviewing locations or assisting potential franchisees with their business plan. Franchisors should provide deposit agreements that clarify how and if the deposit is refunded. If the franchisor does not provide a deposit agreement, potential franchisees should have one created to avoid dependency on verbal discussions. It is important that deposit agreements are read carefully and are reviewed by a lawyer so that there is clarity as to the terms and conditions.

Provincial legislation has put in place certain laws to protect the public regarding franchise deposits. In Ontario, franchisors cannot require potential franchisees to pay a deposit or sign a deposit agreement until the potential franchisee has had 14 days to review the Disclosure Document. In Alberta, the franchisor can collect a deposit prior to the review of the disclosure and entering a franchise agreement but such deposits must be refundable and can only be for a maximum of 20 per cent of the initial franchise fee. The deposit agreement must also be limited to the issues of confidentiality, location and non-use of the franchisor’s information.

Deposits are a great way for potential fran-
Tutorial 3: Intro to Deposits

Chisees to show that they are serious about the franchise opportunity, and provide some initial compensation to the franchisor for preliminary work and to reserve a territory for potential franchisees. The deposit agreement protects the interests of both the potential franchisee and the franchisor.

Study Questions

1. From a potential franchisee perspective, deposits benefit by:
   a) allowing the franchisee to earn interest on deposits held by the franchise system.
   b) allowing the franchisee to opt out of paying royalties.
   c) allowing the franchisee to put a territory on hold while he/she does his/her due diligence, arranges financing, has documents reviewed by a lawyer, or finds an approved location.

2. Deposit Agreements:
   a) define payments made to financial institutions for financing start-up costs involved in franchising.
   b) define how and if the deposit will be returned, provide timelines, and typically address the issue of confidentiality.
   c) define the conditions for paying the franchise fee in monthly installments.

3. There are no provincial legislations regulating franchise deposits. True or False?
   a) True  b) False

4. Deposits are non-refundable. True or False?
   a) True  b) False

Answer Key: 1) c  2) b  3) b  4) b
Disclosure Documents are a summary of information on the franchisor, its executive team, and its franchise agreements. The document is provided to potential franchisees so that they may make a more fully informed business decision. In Canada, franchise systems are required by law to provide a Disclosure Document to prospective franchisees in provinces where franchise legislation is enacted. (Learn more about provincial franchise legislation at www.cfa.ca/Advocacy/Franchise_Legislation). Although franchise systems are only legally required to provide Disclosure Documents in these six provinces (British Columbia, Alberta, Manitoba, Ontario, New Brunswick, and Prince Edward Island), many franchisors provide a disclosure document across all of Canada to assist prospective franchisees in learning about the franchise opportunity.

Franchisors have different application processes for franchisees, but will typically provide the Disclosure Document to prospective franchisees once they have been qualified as a potential franchisee and have shown serious interest in the franchise opportunity. It is not a public document, and is usually only available to serious investors.

When a franchise system fails to provide proper disclosure within the provinces where disclosure is legally required, potential franchisees may have the ability to rescind the franchise agreement for up to two years from when the franchise was granted. In the event that the agreement is rescinded, the law may also provide that potential franchisees will be compensated for all losses incurred in acquiring, setting up, and operating the franchise business. Be sure to speak with your franchise lawyer for details.

The Disclosure Document must meet legislative requirements and disclose all material facts regarding the franchise opportunity and the franchise system’s history. There are required statements pertaining to risk and seeking legal and financial advice. To learn specifically what legislative requirements are in place, you can visit the Advocacy section of the Canadian Franchise Association website at www.cfa.ca/Advocacy/.

A typical Table of Contents of a Disclosure Document might read as follows:

- Corporate name of the franchisor
- Nature of the business
- Business experience of the directors and officers of the franchisor
- Previous convictions, civil actions, administrative proceedings, bankruptcies or liabilities of the franchisor, its directors, officers, and associates
- Initial investment required
- Other fees payable under the franchise agreement
- Estimate on working capital, annual operating costs
- Earning projections
- Training provided, with outline of initial training program
- Financing arrangements
- Assistance provided by the franchisor
- Franchisee obligations
- Marketing fund: use of, past spending, projected spending
- Restrictions on what and to whom franchisees may sell
- Special licences required
- Volume rebates and discount policies
- Obligations to participate in the actual operations of the franchised business
- Trademarks, patent, and copyright information
• Territories available
• Term, renewal, termination, and transfer of the franchise
• Policies regarding dispute resolution

In addition, the disclosure will typically have the following in attachments:
• List of existing franchisees with contact information
• List of terminated, not renewed or cancelled franchisees with contact information
• Financial Statements of the franchisor
• Franchise Agreement
• Table of Contents of the Operations Manual
• Certificate of Franchisor signed by an officer of the company stating that all material facts have been provided and that the information provided is true
• Receipt to be signed and dated by the franchisee acknowledging receipt of the Disclosure Document

The disclosure document is only a summary of important information. Potential franchisees should study the franchise agreement in detail, as this is ultimately the document they will be signing. Legal and financial advisors, along with the franchisor, will all assist potential franchisees in reviewing the documents and in clarifying the obligations as a franchisee of the franchise system. Lawyers with franchising experience can review the disclosure document so that he or she can ensure that it meets all legal requirements. Potential franchisees should also seek advice from an accountant and the bank to ensure that they can financially afford the investment. The bank may also request a copy of the Disclosure Document so that they can make an informed lending decision.

Study Questions

1. Disclosure Documents are provided to potential franchisees:
   a) to assist them in making informed business decisions and to learn more about the franchise opportunity.
   b) to return their personal financial history to the franchise system.
   c) as a marketing material to distribute to other potential franchisees.

2. Franchise systems are currently required by law to provide Disclosure Documents in:
   a) Alberta, Saskatchewan, and Ontario.
   b) Alberta, Ontario, and Nova Scotia.
   c) Alberta, Ontario, and Prince Edward Island.

3. The Disclosure Document will typically include a list of existing franchisees, with contact information. True or False?
   a) True  b) False

4. The Disclosure Document is only a summary of important information. True or False?
   a) True  b) False

Answer Key: 1) a 2) c 3) a 4) a
Most franchises require the franchisee to pay a royalty for the right to use the franchisor’s trademarks and operating system. Royalties are the franchisor’s portion or share of the revenues for allowing you to use the system. By being connected to an established brand, franchisees benefit from using the trademarks and operating system to increase the value of their business assets and future income. Customers are more receptive to products that are associated with a known brand and this in turn generates revenue. Once a franchisee has found a new customer, the operating systems are in place to assist franchisees in keeping them as repeat customers.

The franchisor uses royalties to develop an infrastructure that provides ongoing support to franchisees including:
- Consulting and sharing of best practices
- Arranging suppliers to capitalize on purchasing power
- Research and development
- Operational reviews and ensuring brand consistency
- Accounting systems
- Computerization
- Field support
- Initial training programs
- Ongoing training programs

For a franchise system to be successful, royalties need to be both affordable for the franchisee and large enough for the franchisor to be able to fund the necessary support. Business models vary widely, and as a result, there is no standard royalty amount. Typically, royalties are paid monthly, calculated on the franchisee’s gross sales for the month, and usually do not include legitimate refunds or taxes. Royalty amounts are not the same for every system, and they can start at three to four per cent and range as high as 10 per cent or more. It is common to find royalties between five and six per cent for retail franchises, and eight to 10 per cent for service franchises.

There are numerous variations regarding royalty fees. Some franchisors charge escalating or declining percentages based on different levels of sales. Some franchisors do not charge a percentage of sales, but instead charge a royalty based on a flat fee each month. Others may charge no royalty at all, but instead earn revenues through product sales.

A flat fee royalty is often used when it is difficult for the franchisor to monitor the franchisee’s monthly sales. This system may seem attractive to the franchisee, but a potential downside is that there is no incentive for the franchisor to work with their franchisees to increase their sales. The franchisor receives a flat fee each month regardless of the level of support they provide. The advantage of a flat fee amount is that franchisees know exactly what their franchise costs will be each month.

Revenues to the franchisor through product fees are typically used when the franchisee is distributing a product manufactured or distributed by the franchisor. Examples of a product-based franchise are gas stations, automobile dealerships or soft-drink bottlers. Product franchising derives income from selling products wholesale to the franchisees, with a profit margin for the franchisor built into the wholesale pricing. The franchisee is required by the licence agreement to purchase products from the franchisor.

Royalties are usually non-negotiable and are often preset by the franchisor. If one fran-
chisee is paying four per cent and another is paying eight per cent, there could be potential conflicts within the franchise system. For the most part royalty fees are constant and do not change. Exceptions to this would be if a franchisee were awarded a franchise of a fairly new and emerging franchise system. When joining a franchise system at the early stages of growth, franchisees may receive the benefits of lower royalties as the emerging franchise system is starting out. As the franchise grows, so should the operating systems and support. When renewing their franchise agreement, franchisees may then be faced with an increase to their royalty fees. However, one must remember that the franchisor must make money in order to remain in business, and royalties are an important revenue stream for the franchisor.

Low royalty fees do not necessarily result in an advantage, as low fees can result in the franchisor’s inability to provide franchisees with the necessary level of support and ensure the success of the system.

Most franchise agreements have a clause stating that failure to pay royalties is a breach of the franchise agreement, and may lead to the termination of the agreement. The franchisee may then also be liable for other damages.

The benefits of paying royalty fees often far outweigh the costs. A royalty is a cost of doing business as a franchise. It gives the franchisee the right to operate a business under a proven brand and business model. However, prospective franchisees must always do their due diligence when looking at any franchise opportunity. Speaking with current and past franchisees of the franchise system will help to ensure that the value for the royalties is there.

**Study Questions**

1. A franchisor uses royalty fees to
   a) develop an infrastructure that provides ongoing support to franchisees.
   b) refund customers who return products.
   c) pay for national advertising campaigns.

2. Royalties are often calculated based on
   a) the square footage of a franchise location.
   b) a franchisee’s gross sales for the month.
   c) the number of franchise units a franchisee has invested in.

3. Royalty amounts are the same for every franchise system. True or False?
   a) True   b) False

4. The benefits of royalty fees do not outweigh the costs. True or False?
   a) True   b) False

Answer Key: 1) a 2) b 3) b 4) b
In most franchise systems, the franchisee is required to contribute a certain amount of money, called the advertising fee, for regional and/or national advertising. It’s the pooling of advertising dollars so that the franchisees can create a greater marketing impact by spending collectively on promoting and advertising the brand versus if each franchisee were to spend their advertising dollars independently.

Advertising creates name recognition so that all franchisees may benefit. By combining advertising fees into one fund, there’s more money available to spend on larger advertising projects like radio, large-scale newspapers, and TV.

Advertising fees are calculated on a percentage of a franchisee’s gross sales, and are usually collected once a month. Advertising fees often range from one to four per cent. Some franchisors charge a flat fee, while other franchisors have no advertising fee at all. Some franchisors will put a cap on minimum and maximum advertising fees. With maximum advertising fees, a franchisee is only expected to pay up to a certain amount. When that amount is paid, they’re not expected to pay more. This method helps to alleviate the most successful franchisee supporting the advertising fund. Instead, it becomes a collaboration of all franchisees in the system. Every franchise system works differently, and it’s important for franchisees to understand how franchise advertising fees work.

The management of the advertising funds is often separate from royalties and the general revenues of the franchisor. It’s not considered income of the franchisor, but rather funds collected “in trust” for a specific purpose: to market and advertise the brand, or sometimes to rebrand or refresh the brand. The fund is often collected through a separate bank account, and sometimes through a separate company. Franchisors may charge a management fee for administering the advertising fund. Franchisees can typically request to see the financial statements regarding the advertising fund and how the funds were spent. This ensures that the fund is being used appropriately.

To further support the management of the advertising fund, some franchisors will set up an advisory council or marketing committee, wherein franchisees have a voice and can provide input into the use of the funds. Input from franchisees leads to better decisions on how to utilize ad fund dollars, and leads to greater buy-in to those decisions. Advertising/marketing programs are often evaluated for effectiveness to ensure the return on investment of marketing dollars.

For the most part, advertising fees are constant and do not change. An exception to this would be if a franchisee were awarded a franchise from a fairly new and emerging franchise system. Emerging franchise systems may require lower advertising fees. As the franchise grows, so does brand awareness and the franchisor may find that there aren’t enough advertising fees being collected to support the advertising and marketing initiatives required. They may then ask franchisees to increase the percentage they make to the advertising fund.

In addition to the national/regional marketing funds, franchisees should be aware that they will typically be required to spend money on local marketing initiatives, over and above the advertising fees. While the national/regional advertising drives brand awareness, local marketing initiatives drive
customers to specific locations. Most franchise agreements stipulate that franchisees are financially responsible for carrying out local market advertising each month, often predetermined as a percentage of monthly sales ranging from one to three per cent. Franchisees may also be required to participate in local cooperative advertising with other franchisees in their area.

It’s recommended that franchisees review advertising fee requirements in their franchise agreements. Here are a few questions to ask for a better understanding of the national/regional advertising fund:

• What type of advertising has been done in the past?
• What advertising/marketing initiatives are planned for the near future?
• How is the money held?
• Is the fund segregated from the franchisor’s regular accounts?
• Will the franchisor provide accounting or financial statements pertaining to the fund’s expenditures to the franchisees?
• How much of the fund is used to pay administrative expenses?
• Is there an advisory council set up, and how many franchisees sit on this advisory council?

There are strong benefits to franchisees contributing to the advertising fund. Advertising is expensive, and when all the franchisees put their money together, they’re able to execute advertising initiatives that may not have been affordable otherwise.

Different types of advertising, whether it be radio, newspaper, or TV, can be tested to see what works best for franchisees. A national ad campaign, along with local advertising, can reinforce brand awareness to the customers and, in turn, encourage the customer to patronize franchise locations.

Study Questions

1. Advertising fees are calculated based on
   a) the total number of franchise units in the franchise system.
   b) a percentage of the franchisor’s annual operating budget.
   c) a percentage of a franchisee’s gross sales.

2. Advertising fees range from
   a) 10% to 20%.
   b) 6% to 8%.
   c) 1% to 4%.

3. Advertising fees are not considered income of the franchisor. True or False?
   a) True  b) False

4. Franchisees cannot request financial statements on how advertising fee dollars are spent. True or False?
   a) True  b) False

Answer Key: 1) c 2) c 3) a 4) b
Once you’ve been granted a franchise, one of the first things that will happen is initial training. This training provides you with the knowledge and skills to duplicate the franchisor’s proven business model and to provide a consistent customer experience.

Training is the foundation of a strong franchise system. Successful franchising is all about duplication and consistency.

A brand is strongest when the customer has the same experience each time they visit a franchised location, no matter what time of day or which location. The only way that brand consistency can be accomplished is through training. Initial training is so important that it’s typically mandatory. Some franchisors will even go so far as to stipulate in the franchise agreement that if initial training isn’t successfully completed, the franchise licence can be terminated, or that the franchisee must repeat the training until all of the necessary skills are learned.

During training, new franchisees must set aside any preconceived ideas of how the business should be run, and be open-minded to learning new methods that are being taught by the franchisor. This can sometimes be difficult for franchisees that have been in business for themselves before, especially if it’s in the same industry. The franchisor will be assessing your ability to learn and to adapt to their method of doing business.

The goal of initial training is to ensure that a franchisee has all the knowledge they need to be successful and to duplicate the brand. Someone wanting to get involved in a franchise is usually looking to be shown how to do this, as they don’t want to have to figure it out themselves. In addition to training the critical elements that make the brand, strong franchisors will also provide training in all aspects of running a business. Key areas that are typically covered in an initial training program include the following:

- Initial site selection and store build-out
- Operating standards and procedures
- Technical operations for providing the service or product
- Merchandising
- Recruitment, retention, and management of employees
- Training of employees
- Marketing, advertising, and public relations
- Financial management and controls
- Administration
- Point of sale systems
- Approved suppliers

The duration, costs, and where the training is conducted will vary from franchise to franchise, depending upon the maturity of the franchisor, the complexity of the business model, and the industry. Some franchisors provide training in a group setting at the head office, while others provide training one on one at the new location. Some franchisors provide initial training for several weeks, while others have training that lasts several months. Some franchisors include the training costs in the initial franchise fee, while others charge a training fee over and above the initial franchise fee. Costs for flights, accommodation, and meals while attending the training are typically paid by the franchisee. Who attends the initial training will vary from franchise to franchise. In some cases it’s strictly the franchisee, in other cases it includes the franchisee and key management, and with some franchises, the training may include all new staff.

As a result of the large variations, the only way that you’ll understand the details of
the initial training is to carefully review the disclosure document provided by the franchisor and ask a lot of questions. Often the disclosure document will provide a training outline. Ask the franchisor critical questions so that you have a good understanding of what the initial training entails: who, where, when, and what. Talk to existing franchisees and get their input and impressions of the initial training. Some franchisors may let you review the operations manual or sit in on a part of a training program so that you can get a sense of the quality of the initial training. Don’t be afraid to ask the franchisor your questions to learn as much as you can about the training.

There’s a lot to learn when you’re starting a new business, especially when it’s in an industry in which you have had no previous experience. Good training is more than just how to make the product. It’s all about how to duplicate a complete, proven business model. A good initial training program provided by the franchisor will instill you with confidence and start you off on the right track to building a successful business.

Study Questions

1. Initial training provides a franchisee with:
   a) an opportunity to operate a franchise for six months under the supervision of head office staff.
   b) the knowledge and skills to duplicate the franchisor’s proven business model and to provide a consistent customer experience.
   c) educational opportunities through industry associations.

2. During initial training, new franchisees must:
   a) set aside any preconceived ideas of how the business should be run.
   b) be open-minded to learning new methods that are being trained by the franchisor.
   c) both a) and b).

3. As franchising is a business model, initial training is the same for every franchise system. True or False?
   a) True   b) False

4. Costs for flights, accommodation, and meals are always covered by the franchise system. True or False?
   a) True   b) False

Answer Key: 1) b 2) c 3) b 4) b
Great franchisors don’t stop at providing initial training. They provide ongoing training and support designed to continue to develop the skills of the franchisee and franchisee staff for the duration of the franchise agreement. As with initial training, the details and extent of ongoing training varies widely between franchise companies and requires you to ask a lot of questions. Not all franchisors provide ongoing training, so don’t assume that they do.

Franchise licences will often have a term of five to 10 years, or longer. During this time, the business model should evolve. New products, technology, and innovations require that franchisees have ongoing training to keep current with the evolving brand and continue to be competitive in changing markets. When the quick service restaurant (QSR) franchises started in the ’50s, the menu often consisted of only burgers, fries, and milkshakes. Today, QSR menus have dramatically changed to remain competitive in the market, to respond to the growing trend towards healthier food choices, and to provide menu items for meals such as breakfast. All of this change requires training so that the entire franchise system evolves together, and the customer continues to have the same experience at each franchise location.

Strong franchise systems will define clearly that ongoing training is mandatory in their franchise agreements.

Depending upon the franchise and the industry, ongoing training is often provided for employees of the franchised location. This can be useful in assisting you when dealing with a business that is technical and needs well-trained staff. There is also advanced training for franchisees who wish to take the business to new levels. The ongoing training updates franchisees and their staff on new products, services, or system-wide enhancements. Franchisors will use training to introduce new technology, marketing programs, and other initiatives.

There may be a charge for sending employees to ongoing training, or it may be covered as part of your ongoing royalties. Be sure to review the franchise agreement to determine who is responsible for the costs. Typically, you’re responsible for paying the employee’s salaries, flights, accommodations, and meals during their training.

Franchisors may have reduced these costs by the method of delivering the ongoing training to the franchisee. Some franchisors have set up regional training centres to minimize travel. Others have support staff from head office go out into the field and provide training at the franchised location, and some have set up online training over the internet or via video so franchisees and their staff can get training at their own convenience. Training is also often delivered as part of national conferences or regular regional meetings. Franchisors that put a lot of emphasis on ongoing training will use all or a variety of these methods to deliver the training and get the new information out.

Providers of ongoing training are not limited to the franchisor. The franchisee may look to other education sources over and above the training provided by the franchisor. Suppliers of products to the franchise system may provide training to update franchisees and ensure that the franchise staff is knowledgeable when representing these products to end-user consumers. There may also be tradeshows and conferences put on by industry associations to provide further education. The franchisor often communi-
cates these external training opportunities to the franchisee.

Successful franchisors put a heavy emphasis on ongoing training. The goal is to ensure that the franchise system is consistent as a whole and continues to be competitive as industries change and evolve. The quality and thoroughness of ongoing training often has a correlation to the quality of the franchise system, and ultimately, your success. Be sure to ask questions and ensure that effective ongoing training is provided when you’re researching franchise opportunities and choose to be part of a franchise system that has a long-term view of the business.

Study Questions

1. Ongoing training updates franchisees and their staff on:
   a) new products, services or system-wide enhancements.
   b) head office staff changes.
   c) new products and services of competing franchise systems.

2. There is often a correlation between the quality and thoroughness of ongoing training and:
   a) the franchisor’s level of post-secondary education.
   b) the franchise fee.
   c) the quality of the franchise system and ultimately, your success.

3. You may only receive ongoing training from your franchisor. True or False?
   a) True    b) False

4. Ongoing training is also provided via Internet and video. True or False?
   a) True    b) False

Answer Key: 1) a 2) c 3) b 4) a
The operation manuals of a franchise system are the written documents that provide the franchisee with all the details to duplicate the business model. It’s the proven operating system defined in writing. Critical success factors are identified and communicated so that franchisees can consistently duplicate success.

Depending upon the maturity of the franchise, there may be one general manual or, more typically, the document extends over a series of different manuals. A manual for management may be separated from a manual for employees. A pre-opening manual will often outline how to find the right location and how to build the physical store with typical licensing requirements and build-out processes. An advertising or marketing manual will provide all details regarding the use of the trademarks and provide standardized advertising formats.

A good set of manuals will serve to reinforce the franchise agreement and those areas that require consistency and compliance in order to preserve the integrity of the brand. No matter where in the world, each franchise location should deliver a consistent product or service. At each location there should be the same look and feel within the store, the food or service needs to be the same and provide the same experience to the customer. It’s through this consistent duplication that a solid brand is established.

In the past, operation manuals were typically provided in hard copies to franchisees in a series of three ring binders. Today, franchisors are increasingly making the manuals available electronically through a secure website. This allows updates to be done more easily, and the franchisor can monitor that the changes have been viewed and downloaded by franchisees. Franchisees can print off appropriate sections as needed.

Operation manuals will vary in details and to what degree they outline the business model, but strong franchise systems will leave nothing to chance. There’s an emphasis on price, value, quality, consistency, and customer service. Topics typically covered in operation manuals include:

- Overview of the company, its mission statement, vision, and company values
- Clarity on expectations and roles of the franchisee and the franchisor
- Site selection and store build-out
- Operating standards and policies
- Recipes or service procedures
- Receiving and rotating stock
- Opening and closing procedures
- Detailed job descriptions
- Hiring, training, and leading staff
- Administration, accounting, and reporting requirements
- Supplier contacts and purchasing procedures
- Proper use of the trademarks
- Local marketing initiatives and advertising templates

All of these topics are important, and serve to provide franchisees with the details required to run a successful business. An established system and brand is the most common reason for entering into a franchise. Rather than starting a business and going through the typical trial and error that is experienced by an independent business owner, a franchisee can learn from others’ experiences by simply following the manuals, often saving thousands of dollars in the process.

With so much information to cover, operation manuals may be quite comprehensive.
In a start-up franchise system, the manuals may be more general in nature. As time passes and the franchise develops into an established and mature system, the operation manuals will evolve and become more detailed in scope so as to leave nothing to chance or misinterpretation. A franchisor will often use the services of outside consultants to ensure that the manuals cover all aspects of the operation and are easily understood. The manuals become the reference materials during initial training and throughout the life of the franchise.

To simplify and make the document more user-friendly, forms and checklists often complement the materials to facilitate easy execution. Support materials such as operation software, employee policy and procedures, and training materials for employees, all form part of the operation manuals and serve as a resource for how to use these tools.

In the franchise agreement, there’s typically a clause stating that the operation manuals form part of the franchisee’s obligations. The operating systems and standards outlined in the manuals must be complied with in order to protect the goodwill and reputation of the franchise system. Due to the proprietary nature of the operation manual’s contents, the franchise agreement will clearly state that the manuals are to be kept confidential and returned in the event that the franchise relationship comes to an end.

During operational visits, the franchisor will look for compliance to the operation manuals, and will make reference to the manuals where deviations exist. It becomes the standard reference for the entire operating system. There may be occasions where deviations are found to be positive and actually enhance the operations. These changes are often integrated into the manuals.

Operations are typically always evolving, and therefore the existing operation manuals should be reviewed and updated annually to ensure that the manuals reflect current best practices and systems. Technology and systems change over time. Service or product offerings change in order to meet the changing needs of the customer. Experienced franchisees of established franchise systems often serve on operation manuals committees or participate in focus groups to contribute and identify best practices or processes that work well and should be shared with other franchisees.

Brand awareness is driven by repetition and uniformity, and operation manuals provide the tools to establish a brand. Useful, readable documents provide a framework to standardize the operating system, and are an essential part of any franchise system’s success. It provides an objective standard against which to measure compliance and consistently duplicate the customer’s experience.

**Study Questions**

1. Operation manuals are:
   a) the written documents that provide the franchisee with all the details to duplicate the business model.
   b) the proven operating system defined in writing.
   c) both a) and b).

2. A good set of operation manuals will:
   a) be provided electronically through a secure website.
   b) provide suggested operation procedures that franchisees choose to use.
   c) serve to reinforce the franchise agreement and the areas of operation that require consistency and compliance to preserve the integrity of the brand.

3. An operation manual cannot be changed or added to. True or False?
   a) True  b) False

4. Operation manuals are typically not considered an obligation of the franchisor. True or False?
   a) True  b) False

*Answer Key: 1) c 2) c 3) b 4) b*
Franchisee Advisory Council (FAC) is a group of established franchisees who meet with company executives to discuss business issues that are of relevance to the majority of the franchisees. It’s a structured vehicle for constructive two-way communication between the franchisee and franchisor.

The FAC may operate under different names or formats, but is typically organized by the franchisor. A slight variation is a Franchisee Association. The Franchisee Association is formed by the franchisees and is independent of the franchisor and may function similar to an FAC, but the franchisees set their own structure, policies, and agenda. They’re typically formed when there’s a system-wide crisis, major change or event. In some franchise systems, there may even be an FAC and Franchisee Association both functioning at the same time.

The purpose of the FAC is to provide a formal channel of communication between the franchisees and franchisor about such issues as advertising, field support, operations, and changing market trends. It serves as a sounding board to the franchisor for the implementation of new programs before these programs go system-wide. The franchisor will solicit suggestions and ideas for improvements to the franchise system. It provides a forum for franchisees to voice their mutual issues and concerns. Through the FAC, franchisees can provide advice and input to influence company decisions. Ultimately, the final decision-making authority remains with the franchisor executives.

For the FAC to be effective, both franchisees and franchisor are required to have an open-minded attitude, actively listen, and have a respect for different perspectives. The agenda must be focused on the interests of the overall system, and there must be a focus on finding solutions, setting action plans, and getting results. The FAC will establish policies, by-laws and have meeting agendas in place to keep discussions on track. Without this focus, the FAC can easily go off track and evolve into a session of complaints with no clear resolutions.

How franchisees are selected to participate in the FAC will vary between franchises. In some cases, the franchisor will appoint franchisees, while in other systems there is an election process where franchisees vote as to who will participate on the FAC. The franchisor will typically set some requirements for involvement, such as the franchisee must be in good standing under the terms of the franchise agreement, meet performance standards, and have been in the system a minimum of one or two years. Ideally the franchisees sitting on the FAC are positive, successful, and respected by other franchisees. They have the ability to set aside their own personal agendas to look at what’s best for the system as a whole. There’s also a real commitment of time. Not all franchisees can take the time required away from their business to participate in the council.

The number of franchisees sitting on the FAC will vary from five to 20 or more members, depending upon the overall size of the franchise system. There’s usually an effort made to ensure that different geographical regions and size of operations are represented on the FAC. The term will vary from one to three years, with a staggering of the council members so as to have a balance between experienced and new members sitting on the council at any one time. Franchisors will often limit how many terms a
franchisee may sit on the FAC to give more franchisees the opportunity to participate.

The FAC will meet formally two to four times a year, with informal phone calls and discussions between these meetings. They will meet at the franchisor head office, a resort or conference centre. Sometimes the FAC meeting takes place around the annual convention. Travel, meeting room costs, and other business expenses are often covered by the franchisor, although in some systems such costs are paid entirely by the franchisees through the payment of FAC dues. It’s customary that FAC participants won’t be financially compensated for their time.

Most successful franchise systems today have an FAC. There are no hard and fast rules as to when an FAC should be formed, but the sooner an FAC is put in place, the better. With a smaller system, the FAC may be more informal, but it plays an integral part in forming the direction and policies of the franchise organization.

The FAC can be an important part of a franchise system. It permits constructive two-way communication between the franchisor and franchisees. A positive culture of mutual respect and working together is fostered when the franchisor and franchisees seek to evolve the brand for the benefit of the common good and system as a whole. Successful franchisors recognize that the franchisees have a valuable contribution to make, as they’re working the business model on the front lines everyday. Through an effective FAC, franchisees feel empowered and have confidence that the franchisor is listening to their needs and perspectives.

Study Questions

1. A Franchise Advisory Council is:
   a) a not-for-profit organization that provides guidance and direction to small businesses in the process of becoming franchise systems.
   b) a group of established franchisees who meet with franchise system executives to discuss business issues that are of relevance to the majority of the system’s franchisees.
   c) a committee of the Canadian Franchise Association.

2. In order for the Franchise Advisory Council to be effective:
   a) franchisors cannot be permitted to attend meetings, as they may limit discussion among franchisees.
   b) a third-party representative must chair all discussions.
   c) both franchisees and franchisor are required to have an open-minded attitude, actively listen, and have a respect for different perspectives.

3. A Franchise Advisory Council can be an important part of a franchise system. True or False?
   a) True       b) False

4. Only top-performing franchisees are permitted to serve on Franchise Advisory Councils. True or False?
   a) True       b) False

Answer Key: 1) b 2) c 3) a 4) b
Within your franchise business, typically one of the major expenses is the inventory. Inventory is defined as all the goods and materials that are held in stock and used by a business for the day-to-day operations. It may be the products you sell, as in a retail store. It may be the raw food products that you use to create meals, such as in a restaurant. Or it may be parts or materials you use to provide a service, such as in an automotive repair business.

The amount of inventory that franchisees are required to carry or stock will vary depending on the requirements set out by each franchise concept, and this is usually clearly defined within the operations manual. There are some valid reasons why the franchisor requires franchisees to stock inventory. Sometimes it can take significant lead time for certain suppliers to fill franchisee’s orders, so it’s imperative that the franchisee has inventory to keep the business going. There will be times when some products will be in demand more than others, such as during a promotion. By stocking inventory, the franchisee is creating a safeguard to meet the demands of the customer. By having significant inventory, a franchisee is allowing the customer to purchase what they need when they need it. If you don’t have the inventory to provide products and services, your customer may go to your competition.

Costs of inventory will vary from a few thousand dollars to hundreds of thousands of dollars, depending on the business model. There’s often a tendency for franchisees to gravitate towards getting inventory as cheaply as possible. However, this needs to be weighed against product quality, reliability, and warranties. All of these variables will affect the overall brand. A franchisor will take all of these things into account when sourcing and pricing inventory.

Inventory stocked and used by the business is an integral representation of the entire franchisor’s brand. The franchisor will usually have clearly defined policies regarding what products can be carried. They will also define an approval process if you wish to add or remove specific items from the approved inventory list. An inventory purchase agreement or supplier agreement will address issues like shipping terms, product warranties, pricing, procedure for placing orders, and return policies. The franchisor will provide a clearly defined supply chain, or approved suppliers, from which the franchisee is required to buy all products. (The topic of approved suppliers is covered in more detail in the next tutorial.)

When reviewing a franchise opportunity, ask the franchisor to review inventory policies so that you can better understand the operations of the business and what will typically be a substantial expense. Speak with franchisees and get their perspective. Are they happy with the product quality? What have been their challenges in inventory management, and how have they resolved these challenges? Have the inventory suppliers delivered product in a timely fashion and provided adequate return policies?

As the cost of doing business is on the rise, it’s very simple but important to maintain inventory control. Shrinkage, a business term that refers to unplanned and unwanted loss of inventory, can be caused by theft, damage, spoilage, and accounting errors. Within the operations manual, the franchisor will typically provide details to assist franchisees on how to store the inventory,
minimize loss from shrinkage, and get the most use out of the products.

It’s good business practice to make sure that the entire inventory is insured. It’s possible that the inventory may be covered under a blanket policy for the whole operation. In some cases, depending upon the type of inventory, it may be special coverage that you have to purchase from your local insurance broker. The policies regarding insurance are typically defined by the franchisor within the franchise agreement or operations manual.

Most businesses require inventory to run the business and service the customer, and it often represents one of the biggest expense items. Belonging to a franchise offers some distinct advantages when it comes to inventory, as a strong franchise will often allow franchisees to purchase inventory and products at a lower cost than if they were an independent business, due to volume purchasing. The franchisor will also ensure product quality, good return policies, and will be regularly researching for better inventory sources. While this is being done behind the scenes, it allows you, the franchisee, to focus on building your business and servicing the end customer.

Study Questions

1. The amount of inventory that franchisees are required to carry will:
   a) vary depending on the requirements set out by each franchise system
   b) usually be clearly defined within the operations manual
   c) both A and B

2. The franchisor will usually have clearly defined policies regarding what products can be carried and:
   a) will never allow any new items to be stocked at any time
   b) will also define an approval process if you wish to add or remove specific items from the list
   c) will provide these products free of charge on an annual basis

3. It is good practice to insure the entire inventory. True or False?
   a) True      b) False

4. A strong franchise will often allow franchisees to purchase inventory at a lower cost than if they were an independent business. True or False?
   a) True      b) False

Answer Key: 1) c  2) b  3) a  4) a
Tutorial 12: Intro to Approved Suppliers

Supply chains, or approved suppliers, are suppliers that a franchisor has identified, investigated, and approved to provide their product or service to the system’s franchisees. The franchisee is typically required, under the terms of the franchise agreement, to purchase only from approved suppliers. The franchisee can order with peace of mind and confidence knowing that the products, equipment, and services meet the franchisor’s specific qualifications, and that they’re getting a good price and level of service.

A strong franchise system will use approved suppliers to maintain control over the quality of products and services that’s delivered to the end user consumer. The franchisor is able to create a duplicable business model and ensure the customer has a consistent experience. This in turn reinforces the brand. The franchisor often sets high standards and requirements for the suppliers and regularly monitors them through the franchisees. Strong franchisors will reject suppliers who let their quality control fall below the specified standards that were outlined at the time of approval. Continuing with a supplier that is not up to par affects brand integrity and inhibits optimal franchisee performance.

There are certain considerations that a franchisor will take into account when reviewing a supplier beyond quality. Some considerations include:
• Is the pricing competitive?
• What is the timeline between ordering and receiving product?
• Does the supplier provide regular training on product and equipment to the franchisee?
• Is there merchandising assistance for the franchisee?

• What is the warranty policy?
• Is there a time frame for taking back faulty products and equipment?
• What is the delivery schedule, and what are the charges?
• What are the payment terms? 30, 60 or 90 days?

Franchise systems will often permit franchisees to introduce new suppliers for review, to ensure that franchisees are getting the best offerings available. If the franchisee finds a supplier they feel is superior to the current supplier, they can send the contact information to the franchisor for screening. If the supplier is found suitable, they’ll be added to the approved suppliers list. Some franchisees may find a specific product at a lower price, but it’s important to look at the bigger picture. Although one or two of the products may be less expensive, one must look at the full “basket of goods” being provided by the supplier. All the considerations listed above need to be taken into account.

Franchisors will regularly monitor approved suppliers. This is often done through a supplier’s evaluation questionnaire provided by the franchisor to franchisees. If the franchisor doesn’t provide a standard evaluation form, the franchisee can submit a short written evaluation of the service, quality of product, and pricing received from the suppliers. These reports allow the franchisor to ensure that the supplier is delivering on what was originally agreed to.

Many franchisors will negotiate volume rebates from suppliers. These represent funds that are typically paid back to the franchisor based on buying performance. Rebates are typically disclosed in the franchise agreement, and how these rebates are
used will vary. Some franchisors will keep the rebates to offset the costs of negotiating and monitoring the approved suppliers. Other franchisors will forward the rebates directly to the franchisees. Others will put the rebates, or a portion of the rebates, into the marketing fund for the benefit of the system as a whole.

In general, most Canadian franchisors will use approved suppliers based in Canada. Buying inventory from American suppliers can sometimes end up being counterproductive. Although the price to purchase American products can initially be competitive, when you add in duties, tariffs, exchange rate fluctuations, and delivery charges, the cost of the product can often become prohibitive.

There are numerous benefits to the franchisee for using approved suppliers. These benefits include:

• Ensuring consistency in the brand.
• Providing the best possible prices for franchisees and further discounts based on volume buying.
• Franchisees not having to spend valuable time shopping for products, and instead focused on servicing the customer and building the business.
• Additional benefits negotiated such as warranties, purchasing terms, and after market support.

When a franchisor approaches suppliers to negotiate terms for multiple locations, they will have more clout than if you, as an independent business, approached on your own. An approved supplier program is an integral part of a franchise model, and provides real benefits to both the individual franchisee and the franchise system as a whole.

Study Questions

1. A strong franchise system will use approved suppliers to:
   a) provide varying quality of products and services delivered to the end user consumer
   b) generate income from endorsements and sponsorships
   c) maintain control over the quality of products and services delivered to the end user consumer

2. Franchisors will regularly monitor approved suppliers through:
   a) customer surveys
   b) suppliers’ evaluation questionnaires given to franchisees
   c) teleconferences directly with the supplier

3. Franchise systems will often permit franchisees to introduce new suppliers for review. True or False?
   a) True  b) False

4. In general, most Canadian franchisors use suppliers based in the U.S. True or False?
   a) True  b) False

Answer Key: 1) c  2) b  3) a  4) b
Tutorial 13: Intro to Insurance

When opening a business as a franchisee, you will want to ensure that you are adequately insured. Proper insurance allows you to recover from a financial loss during the occurrence of a specific event. Such events might consist of an employee or customer being injured at the business premises, business interruption due to fire or flood, theft or even employee fraud. Each of these events can cause the franchisee to have a loss of income and also cause the franchisor to incur a loss of royalties.

As you make tenant improvements and stock inventory prior to opening your business, you will want to have insurance coverage commence immediately upon taking possession of the premises.

Typically in a franchise agreement, or within the operation manual, there will be specific insurance requirements that you are obligated to get from insurance providers. Typical insurance requirements include:

- Comprehensive public liability insurance: coverage in case a customer, employee or any other person suffers bodily injury while on your premises or as a result of your service or products.
- Product Liability Insurance: for physical loss or damage to inventory.
- Property Damage Insurance: for property damage due to fire, flood, smoke, vandalism, etc.
- Business interruption insurance: for financial loss from closing of the business due to damage or destruction of property.
- Employment Practices Insurance: coverage arriving from such claims as discrimination, wrongful dismissal or harassment.
- Workers Safety Insurance: coverage for employees at the workplace.
- Auto Insurance: coverage for delivery vehicles, etc.

The franchise agreement will normally require the franchisee to add the franchisor as an additionally insured third party to the insurance policy and provide a copy of the insurance certificate for the franchisor’s records. These requirements are in place to protect the franchisee and the system as a whole and typically do not cost anything more to the franchisee. This also allows the franchisor to claim any lost royalty payments from the insurance company and to protect themselves against lawsuits (which may arise against them through no fault of their own) as a result of such things as personal injury. The franchisee is required to indemnify the franchisor from all fines, suits, claims or actions of any nature related to the operation of the franchisee’s business. Without adding the franchisor, you would be assuming the financial risk, which defeats the purpose of the insurance. It allows the franchisor to operate efficiently and protects them from potentially spending financial resources on issues that are at an individual franchisee location level.

The cost of insurance will vary depending upon numerous factors including, but not limited to, the geographical area, type of business, deductible amounts and the dollar amount of the coverage. Franchise systems that have reached a certain size will often negotiate a group policy with a preferred supplier in order to pass savings on to the franchisee. The franchise agreement will often state that the franchisee may be required to purchase insurance from a preferred supplier. This allows all franchisees in the system to take advantage of the franchise system’s size and buying power.

In addition to the required business
insurance, franchisees will want to look at optional insurance packages to further protect themselves and/or their employees.

For example:
- Life Insurance
- Disability Insurance
- Critical Illness Insurance
- Health Plan Insurance

Employees are increasingly expecting and seeking higher standards for medical service and financial security. Group insurance and benefit plans for employees allow employers to be competitive and attract and retain good employees. A group plan is significantly lower in cost compared to individual coverage.

This article is by no means an exhaustive list of the insurance available. Not all coverage will apply to your specific circumstance. Your specific insurance needs will vary depending upon the nature of the business and exposure to potential liabilities. Consult with your franchisor to determine the specific needs required and consult with an insurance broker. They will be able to assess your specific circumstances and provide advice as to what products are best for you and your business. Be sure to have them fully explain the specific details of the insurance policy and the coverage and the restrictions that apply. A list of insurance companies specializing in the franchise model can be found on www.cfa.ca.

Ultimately insurance is planning for worst-case scenarios. With insurance in place you can focus your energies on building a successful business and not be worried about financial loss due to hardships that are often outside your control.

Study Questions

1. Typically in a franchise agreement, or within the operation manual, there will be specific insurance requirements that you are obligated to have including:
   a) Home owner’s insurance.
   b) Travel insurance.
   c) Auto insurance.

2. Proper insurance allows you to recover from a financial loss during the occurrence of a specific event such as:
   a) employee or customer injury.
   b) business interruption from fires or floods.
   c) theft and fraud.
   d) all of the above.

3. A group plan with the franchise system is significantly lower in cost compared to individual coverage. True or False?
   a) True  b) False

4. All insurance needs are the same for all franchised businesses. True or False?
   a) True  b) False

Answer Key: 1) c  2) d  3) a  4) b
A s a franchisee, one of the roles you will spend a lot of time in is the area of recruiting staff. Unless you are operating a one-person operation, this will be an important part of your business. Recruiting staff is an ongoing function of management and well-selected employees can dramatically improve the success of the business.

Although some franchisors will assist the franchisee in hiring staff during the startup phase of a new location, it is typically the franchisee’s responsibility once the location is up and running. Most franchise agreements will clearly state that you are required to maintain a sufficient number of staff, you must take the necessary steps to ensure that they are trained, and that your staff represent the brand well to ensure good customer relations. The franchise agreement will typically further clarify that, as a franchisee, you are responsible for all decisions related to hiring, firing, training, wages, hours supervision and discipline. The employees are clearly working for you and not the franchisor.

Staff requirements vary depending on the type of business you invest in. A full-service restaurant may have as many as 80 to 100 employees, whereas retail concepts may require only one or two. Staffing requirements may also vary depending upon seasonal variations. For example, retail tends to have higher staffing needs during the Christmas shopping season.

In industries where there is a high need for labour, progressive franchisors have developed recruitment departments to address current labour shortages in Canada and also have programs to bring in foreign workers. Progressive franchisors also look at ways to reduce the labour needs of the franchisees through outsourcing certain aspects of the operations.

The type of staff you require will vary depending upon the business model. Often the business will rely on you and your staff’s ability to build relationships with customers and sell your product. As a result, you will typically want employees who are people oriented. You are looking for staff that reflect that brand’s values, have the ability to learn, and are available the hours required. The more flexible employees are, the easier scheduling will be.

Have clarity on the staffing needs of the business before hiring your staff. The franchisor will often provide details of staffing needs in the operation manual, as well as provide specific job descriptions and tools to assist you in the recruitment process. The franchisor will also typically provide tools in the form of leadership training, staff surveys for feedback and recognition programs for staff retention.

The recruitment process will vary but typically involves the following steps:
1. Advertising to generate enquiries
2. Reviewing resumes or applications
3. Conducting interviews, either individually or by groups
4. Checking references
5. Orientation and training

The franchisor, based on the experience of existing franchisees, can provide you with best practices for the entire recruitment process.

What you pay employees is dictated by labour laws as well as what is required to attract employees in your specific market. Today’s market is competitive and you will want to be aware of what other companies
are paying by doing a quick survey of the market.

The cost of employees goes beyond the paycheque. Depending upon the business and market, there will be the costs of employment taxes, workers compensation and benefits. But the biggest cost is the cost of turnover of employees. You will want to ensure that you take the time to hire the right employees and then provide a great work environment that will encourage good employees to stay. You can improve staff retention and reduce your hiring costs by becoming an “employer of choice.” Employees today are looking for:

• Career development and advancement opportunities
• Ongoing and progressive training
• Recognition
• A fun environment
• Flexible work hours and time
• Fair treatment
• Involvement and consultation with management

Throughout the recruitment process, you need to be aware of the employment standards and labour laws that are applicable to your area. Provincial Human Rights Codes prevent employers from discrimination when hiring and managing employees. There are certain questions that cannot be asked during the recruitment process such as race, age, sexual orientation and religion. Instead you need to focus on the position being filled and identifying the characteristics that a successful candidate needs to fill this role. There are also privacy laws to be aware of. You do not want to disclose personal information of your employees. It is the franchisees’ responsibility to become familiar with all applicable laws and to adhere to them.

Your business success is dependent upon you finding the right people who will deliver great customer service. No matter how good your employees, it does not diminish the need for you to be involved in the business. Sales and customer satisfaction often increases when a franchisee is actively involved in the day-to-day operations. All franchisors will agree that there is nothing that can replace the dedication and commitment of a franchisee who has a vested interest in the success of the business and who has made a financial investment.

Study Questions

1. Most franchise agreements will clearly state:
   a) that you are required to maintain a sufficient number of staff.
   b) who you can and cannot hire.
   c) that all staff are employees of the franchisor.

2. The cost of employees goes beyond the paycheque. Some other costs are:
   a) per diems, profit shares and RRSP contributions.
   b) clothing allowances, transportation reimbursements and housing.
   c) employment taxes, workers compensation and benefits.

3. As a franchisee, your employees work for you and not the franchisor. True or False?
   a) True  b) False

4. Provincial Human Rights Codes prevent employers from discrimination when hiring and managing employees. True or False?
   a) True  b) False

Answer Key: 1) a  2) c  3) a  4) a
All franchise agreements have a fixed term. They come to an end. That is the nature of a licensing relationship. A licence has a beginning and an end. You are not buying the right to use the brand but instead leasing it, like the lease of a commercial space. At the end of the term you have the ability to renew the agreement for a further term, or you can end the relationship.

The length of the term will vary. Often the term is five or 10 years and sometimes as long as 15 to 20 years. The length of the term is outlined in the franchise agreement. It will often coincide with the length of your lease. The length is dependent upon the total investment amount. If you have invested over $1 million, you will typically require a longer term than, say, if you invested $100,000. The term should be long enough to pay off your business loans and get a return on your investment.

At the end of the term, you typically have an option to renew. The option is usually your choice, provided that you meet the renewal conditions. Such conditions might include:

- You are in good standing and in compliance under the terms of the existing franchise agreement
- You have notified the franchisor of your desire to renew (typically six months prior to the end of the term)
- You sign a current franchise agreement, which may or may not have terms and conditions that are substantially different from the original agreement
- You pay a renewal fee
- You upgrade your location and equipment to the current standards, specifications and/or image
- You have secured a lease on the location
- You and your staff complete renewal training
- You sign a general release regarding the expiring license agreement

Be sure to give the appropriate notice of your desire to renew. If you forget and miss the deadline the franchisor may assume that you are not intending to renew and find another franchisee to take over the location at the end of your term.

The length of the renewal term is often the same as the original term, but sometimes is shorter. Some franchises allow unlimited renewals, while other franchises only permit one renewal term. Each franchise is different and you need to read the terms of your franchise agreement to get clarity.

Upon renewal, be aware that the new franchise agreement may be substantially different from the original. The franchisor may increase the royalty or other financial commitments, thus changing the financial returns of the business. This is common if it was a new franchisor and you were one of the first franchisees. For established franchisors, however, the financial terms typically remain the same and instead the revisions in the agreement reflect changes in law to more fully protect franchisor and system-wide interests. There may also be changes to reflect new technology or adjustments to territories to reflect changes in population and demographics.

As part of the renewal process, you may be provided with a disclosure document if you are located in Ontario, Alberta, P.E.I. or New Brunswick. Provincial regulations in general state that a renewal is exempt from requiring disclosure if there has been no interruption in the operation of the business, unless there has been a material change.
The fact that you are being required to sign a new franchise agreement that may be different could be considered a material change. Franchisors are wise to lean on the side of caution and provide full disclosure.

If you choose not to renew the franchise agreement, the franchisor has the right to issue the franchise to someone else. You would be giving up your rights to use the brand and operating system of the franchise. Most franchise agreements have a non-competition clause that would prevent you from continuing to operate the same business independently. You would have to go into another line of business, but, after 10 years, you may be ready for a change. In many cases, however, if you are looking for an exit strategy, you would be better off financially to renew the franchise agreement and sell the franchise assets to a new party and transfer the licence. This allows you to get a greater return on your investment or, in some cases, minimize your losses.

Be sure to read and fully understand your franchise agreement with regards to the term and renewal. Have a franchise lawyer review the new agreement and assist you in getting clarity as to your new obligations, which may be substantially different from the ones you had. A good understanding of the terms of your new franchise agreement will allow you to better plan your business and your personal future. 🌟

Study Questions

1. The length of the Term of Agreement is always 10 years. True or False?
   a) True   b) False

2. You should give notice of your intent to renew your franchise agreement:
   a) immediately after signing your initial agreement.
   b) after the term of your initial agreement has expired.
   c) at least six months prior to the end of your term.

3. Upon renewal, your new franchise agreement may be substantially different from the original. True or False?
   a) True   b) False

4. If you choose not to renew your franchise agreement:
   a) the franchisor has the right to issue the franchise to someone else.
   b) you give up your rights to use the brand and operating system.
   c) you may not be able to continue to operate the same business independently.
   d) all of the above

Answer Key: 1) b 2) c 3) a 4) d
Tutorial 16: 
RENEWAL FEES AND REDESIGN COSTS

When it comes time to renew your franchise agreement, there will typically be some costs in the form of a renewal fee and redesign or remodeling costs. You will want to plan for these costs and be prepared financially when it comes time to renew your franchise agreement for a new term.

The costs of renewal will be defined in your franchise agreement. Costs will vary from zero to a few hundred dollars to a percentage of the current franchise fee or, potentially, to the amount of the initial franchise fee. How much the franchisor will charge reflects their attitudes and market conditions. A low fee that basically covers the administrative costs communicates that the franchisor values its franchisees and retaining these relationships. A high renewal fee communicates that the franchisor places a high value on the brand. They know that if you don’t want to renew, they have other prospective franchisees that will gladly assume the franchise.

The renewal fee represents the opportunity cost lost by not awarding it to someone else. With many franchisors the fee is typically somewhere in the middle, representing both of these attitudes. On average, the renewal fee is between $3,000 and $5,000, paid in full at the time of entering into a new franchise agreement for the renewal term.

It makes sense for the franchisor to encourage renewals and keep costs to renew low. The alternative is to spend a lot of time, effort, and money on finding new franchisees, finding new locations and training the new franchisee. There is the potential loss of goodwill resulting from customers who had built relationships with the local franchisee operator, not to mention the strained relationships with remaining franchisees who see their fellow franchisees leaving the system.

Upon renewal, there will typically be a requirement to upgrade and/or modernize. This may include changes to the branding elements, equipment and technology, and/or remodeling the physical premises of your location. This requirement is found in your franchise agreement. If your agreement has a longer term, it may require that changes be made during the term as well, not just at the time of renewal. Franchisors will provide a reasonable amount of time to make the changes, but will often not renew your agreement unless the changes are made.

Changes in the system are required in order for the brand to evolve, develop, and remain competitive. Clauses requiring change allow the system to evolve, while maintaining uniformity and consistency over time. Franchisors will often involve the franchisees and allow them to provide input to the changes through a franchisee advisory council or committee. Examples of changes that might be required could be as simple as repainting the walls and replacing carpet with new colours. The colours that were in fashion in the ‘80s may look very out of date today. There may be strategic changes.

Drive-ins were popular in the ‘50s, whereas today it is the drive-thru. Or there may be menu changes. Adding pizza to the menu would require pizza ovens and other modifications to the kitchen.

All of these changes are at a cost, ranging from a few hundred dollars, to hundreds of thousands of dollars. Some franchisors will offer financial assistance to facilitate these changes. Some franchise agreements will set a cap as to the cost of these changes, but it is very difficult for franchisors to forecast what the changes and the applicable costs
will be five to 10 years into the future. As a result, the franchise agreement will speak of required upgrades in general terms.

Another cost that may be incurred at time of renewal is training to upgrade the franchisee and staff. If there is new equipment, your employees will need to be trained on the new equipment and processes. You will need to cover costs of your staff as they go through the training, as well as paying the travel, accommodation, and meals for the trainer to come to you or, alternatively, for you to go to head office.

Before you renew your agreement, have a full understanding of what the total costs are going to be and ensure that you have access to the funds required. Your franchisor will assist you. You will want to ensure that you have sufficient time in the renewal term to get a return on your new investment. Successful franchisors will be sensitive to this fact, while at the same time balancing this against the need to keep the brand current and contemporary. It is in the best interests of the brand and the system as a whole.

Study Questions

1. Renewing your franchise agreement might require updates to:
   a) branding elements.
   b) equipment and technology.
   c) the physical premises of your location.
   d) all of the above

2. Some franchisors offer assistance or set a cap for the cost of these changes. True or False?
   a) True  b) False

3. The cost associated with renewing your franchise agreement:
   a) is always a few hundred dollars.
   b) is always the same amount as the initial franchise fee.
   c) is always a percentage of the current franchise fee.
   d) varies depending on the franchisor and market conditions.

4. You and your staff might have to upgrade your training when you renew your franchise agreement. True or False?
   a) True  b) False

Answer Key: 1) d  2) a  3) d  4) a
Franchise agreements will typically address the issue of territories and/or protected areas. Protected areas may be defined by distance radius, postal codes, municipalities, cities or simply outlined as within the four walls of the franchised location. The territorial boundaries are defined in the franchise agreement and will often state that no other franchisee shall be licensed or a corporate store opened to operate under the same brand within the territory, provided that your franchise licence is in good standing and you are living up to all terms of the franchise agreement.

The intent of the exclusive territory is to protect your business sales from being cannibalized by other locations offering the same products and services in close proximity to your location. Such encroachment could detract from your business sales.

It should be understood that not all franchise agreements have exclusive territories and one should read the franchise agreement carefully to fully understand the implications. Some franchise agreements will clearly state the territory is non-exclusive or simply defined as the address of the physical franchised location. Franchisors are becoming more and more reluctant to grant exclusive territories or protected areas as it restricts the franchisor’s ability to grow the brand. Over time, new retail projects are built that provide great opportunities to build market share. The population may have substantially increased and now supports the brand having two locations. If the franchisor does not take advantage of the opportunity to expand, their competition will often do so. This may cause harm to the existing franchise location.

The Right of First Refusal is often a way that the franchisor addresses this issue. In the event that the franchisor determines that the demographics have changed and a second location is justified within the territory, you are provided the first opportunity to open the second location. If you choose not to do so, the franchisor is free to open the new location or franchise it to someone else and your original territory size is reduced accordingly.

Some franchises are sales- and marketing-driven, not location-driven. Examples of these are those specializing in home renovations, window washing and other services. They may be home-based businesses or operating out of a vehicle. The franchisee goes to the customer rather than the customer coming to a location. In these circumstances, an exclusive territory would provide you with the benefit of not having to compete directly with other franchisees offering the same service and/or product. However, your growth becomes restricted and limited to the size and potential of your territory. If you are referred business outside of your territory, you are required to turn the business over to another franchisee servicing that area. What if the sale is based on long-term relationships that you have developed? This has often been addressed by the franchise agreement stating that the territory is your primary market of responsibility and the only market that you can directly advertise in, but that you can service customers outside of your territory that have been referred to you or are generated through networking and advertising done within your defined territory.

From a franchisor’s perspective, it has been learned that some franchisees are more sales- and marketing-oriented than others. This results in some territories being fully capitalized and generating strong sales and brand recognition, while other territo-
ries remain underdeveloped and not generating the revenues they should. Franchisors are addressing this by setting policies and defining minimum sales quotas within the franchise agreement. If sales quotas are not met, then exclusivity may be lost, allowing the franchisor to enter the market or license other franchisees within the area. There is also a common practice when the franchisor is looking to establish a location in close proximity to an existing location. The franchisor will usually conduct a study to determine the potential impact on sales of the existing location. If encroachment is determined to be a significant possibility, the franchisor may abandon its plans for the new store opening or provide some kind of revenue sharing with the existing location.

The franchise agreement may have other restrictions, restraints or permissions that further define and clarify your territory rights. Examples of these clarifications include:

- Restriction of sales regarding national or institutional accounts. These may be handled by the franchisor.
- Prohibition on the solicitation of sales from other franchisees of the franchise system so as to prevent franchisees from cannibalizing each other, usually when there are no protected territories.
- Reservation of the franchisor’s right to franchise different brands within the territory, which may or may not be a direct competitor to you.
- Restriction and restraint of Internet or mail sales, which have no definite boundaries. Sometimes franchisors will reserve these sales for themselves and share the revenue with franchisees or will have the orders filled by the nearest location.

Reputable franchisors are as concerned about encroaching upon and cannibalization of locations as the franchisee. The franchisor also has a legal responsibility to act in good faith and conduct fair dealings. The specific territory and protected area policies and terms should be outlined in the franchise agreement. As a complex issue, it requires careful reading of all terms and conditions so that you have a full understanding of exactly how protected your territory is. Have a lawyer who is familiar with franchising assist you in understanding your franchise agreement and talk to existing franchisees to learn how territory issues have been dealt with by the franchisor in the past.

**Study Questions**

1. Territorial boundaries are defined in the franchise agreement and will often state that:
   a) up to two other franchisees can open and operate under the same brand within the territory.
   b) only corporate locations can open and operate within the territory.
   c) no other franchisee shall be licensed or a corporate store opened to operate under the same brand within the territory.
   Answer: c

2. The right of first refusal means:
   a) you are provided with the first opportunity to open a second location within the territory.
   b) you have the right to deny any opening of a second location within your territory.
   c) the franchisor has the right to refuse the opening of a second location if you wish to do so.
   Answer: a

3. When exploring the possibility of opening a second location near a protected territory, the franchisor will usually conduct a study to determine the potential impact on sales of the existing location. True or False?
   a) True b) False
   Answer: True

4. Specific territory and protected area policies and terms should be outlined in the franchise agreement. True or False?
   a) True b) False
   Answer: True
Within franchising, there are a variety of different growth formats used by franchisors. These formats provide different opportunities for a prospective franchisee. Beyond the single-unit franchise agreement (in which a franchisee has a single location), there may be the following potential growth opportunities within a franchise brand. Check with the franchisor to determine if these opportunities exist with the particular brand you are looking at.

- A multi-unit franchisee will have multiple single-unit franchise agreements. These may or may not be in the same geographical area. The multi-unit franchises may be tied to an area development agreement or master franchisee agreement.
- An area development agreement is an agreement to open a specific number of locations within a specific geographical area within a specific period of time. The area developer is provided exclusivity for an assigned geographical area, provided that you meet the development schedule or timelines. Note that, as each location opens, the area developer enters into a single-unit franchise agreement for each specific location.
- A Master Franchisee Agreement provides the master franchisee with the ability to sub-franchise and grant franchises to other franchisees within an assigned territory (as opposed to area developers who are opening all the locations themselves). The master franchisee will typically be responsible to open at least one location themselves and provide some level of support to the franchisees within his assigned territory. For this support, the master franchisee will receive a portion of the royalties as compensation.

Although these definitions are generally consistent amongst franchisors, there are sometimes variations. For example, some franchisors refer to the “area developer” as a “master franchisee.” Be sure to get clarity from the franchisor as to what their definition is so that you are both speaking the same language.

Multi-unit, area development or master franchisee agreements are all similar in that they provide the licensee with the ability to generate revenues from multiple locations. Rather than investing in one location, you invest in multiple locations so as to diversify and improve your odds of success. If one location is underperforming, it can be offset by the success of other locations. You can also have ongoing economies of scale where you share administrative costs between the locations. You can share training expenses, employees, and management. The franchisee has greater earning potential without having to go through more training or a learning curve, because you are familiar with the brand and the operating system and are simply duplicating what you know.

Multi-unit, area development, and master franchisees will usually come at a higher initial financial investment, which is offset by the potential for greater returns. You will want to ensure that you have the financial resources to open the multiple locations. Often lenders will want to see some proven performance from the first few locations before lending additional funds for continued growth, especially in today’s current economy. If you fail to meet the schedule outlined in the area development or master franchisee agreement, the franchisor may terminate the licence. You would lose any up-front fees that you had paid. You would be permitted to
continue to operate the stores that you had opened but could possibly lose exclusivity for the development area.

There is the challenge that, as the brand evolves, you may be required to upgrade or remodel. This may include changes to the branding elements, equipment, technology, and/or remodelling of the physical premises of your locations. With multiple locations, this can be expensive.

For a master franchisee, these costs will be shared with the other franchisees that you are supporting. However, you may have the challenge of operating your own locations while, at the same time, working to find sub-franchisees. You will need to hire support staff and have the infrastructure to provide the support. You will need to grow quickly in order to have the revenues to cover the costs of this infrastructure.

A person who has strong leadership and management skills would do well as a franchisee in any of these multi-unit situations. They must be able to delegate the management tasks, as they cannot be at every location at the same time. The franchisee must have the ability to work on the business rather than in the business by overseeing multiple locations at the same time.

As with any franchise opportunity, do your due diligence and fully understand your rights and obligations. With multi-unit opportunities, you will need to review the area development agreement or master franchisee agreement, as well as any single-unit franchise agreements. You will need to review the single-unit agreements, as each one will be entered into as you open the location. Talk to other franchisees who are operating under multi-unit agreements to fully understand the opportunity from someone who has been there and done it.

Study Questions

1. An area developer is a franchisee who:
   a) has multiple single-unit franchise agreements.
   b) has more than one protected area within a 100 km radius.
   c) has agreed to open a specific number of locations within a specific geographical area within a specific period of time.

2. The Master Franchisee Agreement provides the master franchisee with:
   a) a controlling share in publicly-traded franchise companies.
   b) the ability to sub-franchise and grant franchises to other franchisees within an assigned territory.
   c) a minimum of five single-unit franchise locations within the province.

3. Multi-unit, area development or master franchisee agreements are similar in that they provide the licensee with the ability to generate revenues from multiple locations. True or False?
   a) True  b) False

4. A multi-unit franchisee must have the ability to work in the business rather than on the business by working in multiple locations at the same time. True or False?
   a) True  b) False

Answer Key: 1) c 2) b 3) a 4) b
Many franchises will require that their franchisees operate out of a retail, office or commercial location. In these circumstances, you, as a franchisee, would enter into a head lease or sublease agreement. It is important that you understand the agreement and contractual relationship that you are entering into.

A head lease is where you are in a direct contractual relationship with the landlord. The franchisor will typically require in the franchise agreement that such lease documents and the location are approved by the franchisor before signing. The franchisor wants to ensure that it is a viable location and that the terms are reasonable. However, the franchise agreement will typically state that the franchisor’s approval of the site does not represent or warrant the success of the location. The franchisor cannot predict success, as there are many variables that will affect your business.

In many circumstances, the franchisee will sublease their space from the franchisor, with the franchisor on the head lease with the landlord. This is done when the franchise’s success is very location-driven or where the landlord requires a strong covenant. A sublease arrangement allows the franchisee to have access to locations that they would not have access to otherwise. The franchisor will retain control over the site by entering into a lease directly with the landlord and then subleasing the location to the franchisee on principally the same terms and conditions. In the event that the franchisee is not successful or abandons the business, it is far easier for the franchisor to take over the location when they are on the lease directly.

A third situation is where the franchisor and franchisee go on the head lease with the landlord, making it a three-party, or “tripartite” agreement. In the event that the franchisee is in default of the lease, the franchisor would have the right to cure the defaults or take over the location. The agreement may also allow the franchisor to assume the lease in the event that the franchisee decides not to renew at the end of the lease term or the franchise agreement is terminated. From a franchisor’s perspective, this gives them the ability to control the location without the obligation and liability. However, from the landlord’s perspective, it limits their options and thus landlords are reluctant to sign three-party agreements. They often want to have flexibility to rent the space to someone else in the event of default.

These three different leasing options are a function of balance between control and risk. If a franchisor wishes to have control of a great location, it will assume liability and go on the lease and then sublease to franchisees. For a start up franchisor, this could be a substantial risk and the third-party agreement would provide a viable solution. For a well-established franchisor, risk is less of an issue and they will often want the ability to step in and take over the location in the event of the default, so as to preserve the great location and the established customer base.

A franchisor will typically have a “cross default” clause in the franchise agreement stating that a default on the sublease or lease agreement is a default of the franchise agreement.

Regardless of whether you are on the head lease or in a sublease or a tripartite agreement, be sure that you fully understand your legal and financial obligations under
the lease. Typically, the total occupancy costs are different from the base rent that is quoted. Be sure you budget for the total occupancy costs for the space and not just the base rent.

Total occupancy costs will often include the following:
• Base Rent – Usually quoted as an annual cost per square foot.
• Common Area Maintenance (CAM) – Your business’ share of such costs as security, snow removal in the parking lot or cleaning of the common areas.
• Percentage Rent – Some landlords in high traffic retail locations will request a percentage of your gross sales.
• Property Tax – Typically, you will pay your portion of the property tax, based on your square footage.
• Merchants’ association or marketing fund – Large shopping malls or complexes will have tenants share costs for mall promotions and events; again, the amount is allocated based on your square footage over the total amount of leased square footage.

Your rent payments are usually paid monthly directly to the landlord, with certain items, such as property tax, paid annually. The merchants’ association or marketing fees are often paid quarterly. In sublease arrangements, the franchisor may require that you pay them directly and then the franchisor pays the landlord. In these cases, get clarity as to whether or not the franchisor is charging a fee or ‘up-charging’ for being on the head lease. This can sometimes be justified, for the franchisor is taking on added liability for you to access a great location, but it should be disclosed.

It is important that you fully understand your obligations under the lease or sublease agreement. Have a lawyer review and explain the documents before signing. Once you are open for business, work at maintaining the relationship with your landlord and franchisor so as to avoid difficulties down the road. If you foresee problems in making lease payments, don't hide this fact. Instead, communicate the issue to both your landlord and franchisor so that there are no surprises and work with them to find solutions for payment.

Study Questions
1. In a sublease arrangement, the franchisee:
   a) Leases their space from another franchisee
   b) Leases their space from their franchisor, who is leasing it from the landlord
   c) Purchases their space outright

2. Total occupancy costs for a leased space can include:
   a) Base rent
   b) Property tax
   c) Merchants’ association fees
   d) All of the above

3. No matter which type of leasing arrangement is chosen, the franchisee should fully understand his or her legal and financial obligations as outlined in the lease agreement. True or False?
   a) True b) False

4. In a head lease, the franchisee is in a direct contractual agreement with the landlord. True or False?
   a) True b) False

Answer Key: 1) b 2) d 3) a 4) a
Leasehold improvements are fixtures or improvements that are attached to the retail or commercial space and installed by the franchisee when setting up a new location. Upon expiration of the lease, these improvements remain with the space and become the property of the landlord. Examples of such improvements include:

- walls
- doors
- cabinets
- light fixtures
- floor coverings
- machinery and equipment if bolted down to the floor

These improvements are required to make the space work for the needs of the business.

As a franchisee, you are typically responsible for all the costs associated with constructing the space and leasehold improvements, as well as ensuring that this is done according to the franchisor’s specifications and standards. The franchisor is responsible for the integrity of the brand and will usually provide standard prototype plans and drawings. An architect would then be required to create new plans that are specific to your space and that comply with local bylaws and city requirements, while still meeting the franchisor’s standards. Some franchisors have design services as part of the franchise support or as an added fee. The franchisor will require that plans be approved by them before construction starts.

Depending upon condition of the space and the business model, the required leasehold improvements can be extensive. If you are dealing with a brand new building with a “shell” space (bare cement walls and floor) and are constructing a restaurant, you will require plumbing, HVAC, heating, and electrical, in addition to the typical improvements. Costs can range from $100,000 to well in excess of $700,000, depending upon the type of business, size, and condition of the space. These costs can sometimes be reduced by the landlord through a leasehold improvement allowance or a lump-sum payment upon completion of the space.

In some cases, you may acquire a space that has pre-existing leasehold improvements. This could reduce the costs, but not necessarily. In some cases, few improvements can be salvaged for your use. This means you are paying for demolition of the old, as well as new construction to bring the space to the franchisor’s specifications. Many times there are costs associated with bringing the old improvements up to standard building codes, such as having extra washrooms and proper kitchen electrical, gas, plumbing, and ventilation. Don’t assume there are savings by dealing with existing improvements. Work with the franchisor to have a thorough site assessment done.

Depending upon the franchise, you may be required to build out the location through the hiring of a general contractor. Ask the franchisor to recommend a general contractor who has built out stores for the franchise in the past. You want to select someone who is reputable and can get the job done on time, on budget, and within the franchisor’s specifications. Check references and visit locations that this contractor has built in the past.

Whether it is through a general contractor or the franchisor, be sure to get specific quotes as to what the build out of the location will cost and get it in writing. There will often be unforeseen costs and delays. Address beforehand what happens if costs exceed, say, a 10 per cent variance. You may be able to negotiate that such overruns are the general contractor’s responsibility or
that there is some compensation to you for delays.

In reviewing the costs for a store build out a franchisee will often comment that the costs seem high. Avoid the desire to negotiate the improvements and reduce costs. Quality construction is expensive, but typically necessary. You will always be able to find a cheaper piece of equipment or specification of carpet, but usually at the expense of quality or warranty service. The cheaper kitchen equipment may have a tendency to break down. How much will this cost you in lost revenues when your restaurant is closed for equipment repairs? How does it affect your business when the carpet is frayed and worn in high-traffic areas after only a year, and in need of replacement?

Throughout the entire process, the franchisor will be overseeing the plans and construction to ensure the finished location conforms to franchise concept specifications. The franchisor will typically make regular site inspections during construction to ensure that the brand is consistent and that the location has the same look and feel as all the locations of the brand. You may be able to provide input, but it will be the franchisor that will make the final decisions. Recognize that they have the experience and that often there is a strategy behind the design. You may feel that the kitchen is too small and want to make it bigger, yet the franchisor recognizes, through experience, that a smaller, well-designed kitchen creates greater work efficiencies and permits more front of house space, thus allowing more tables and greater revenues. If you object and fail to comply with the standards, you may risk being in breach of your franchise agreement and incur costs to redo certain parts of the build out in order to conform to franchise standards.

Leasehold improvements and store build outs can be overwhelming. There are a lot of details and it is a large investment. Make sure that you select the right contractor and have the build out monitored closely by the franchisor. Ask questions so that you understand the decisions being made, but rely on the experience of the franchisor. That is part of the value of a franchise.

Study Questions

1. **Leasehold improvements:**
   a) are fixtures that are attached to a retail or commercial space.
   b) are installed by the franchisee or tenant when setting up their business.
   c) can include machinery and equipment that is bolted to the floor.
   d) All of the above

2. When building out a new franchise location, a franchisee should:
   a) pick the first contractor they speak with so construction can begin immediately.
   b) consult closely with their franchisor to ensure the location is built to the system’s specifications.
   c) always go for the cheapest construction materials and equipment.
   d) assume that all unforeseen costs and delays will be absorbed by either the contractor or the franchisor.

3. It always ends up being cheaper for a franchisee to lease a space with pre-existing leasehold improvements. True or False?
   a) True  b) False

4. During build out of a new location, the franchisor will usually have the final decision on all aspects of the build, especially those relating to brand consistency. True or False?
   a) True  b) False

Answer Key: 1) d 2) b 3) b 4) a
Most franchise agreements require the franchisee to report information to the franchisor on a regular basis. This is frequently done on a monthly basis and can be submitted as written reports or digitally. It may simply be financial reports that are generated through point-of-sale systems, online reporting systems or dashboards. Sales, as well as key operating metrics such as billable hours or average customer spend, are looked at. Profit and Loss statements are typically reported annually. Depending upon the franchise system, reports may be required more frequently.

Franchisee reports are required by the franchisor for several reasons. First, franchisors want to ensure that they are receiving proper royalties. Royalties are often a percentage of the gross revenues, less collected taxes and refunds. Such royalties cover the costs and expenses associated with providing support to the franchisees and the system, as well as providing a profit to the franchisor and its shareholders. It provides the revenues to continue to build the brand. For the franchisees that are paying their fair share of the royalties, it is not fair that they do so while others do not. The non-compliant franchisees, by hurting the franchisor’s financial cash flow, are considered a threat to the system.

Second, the franchisor wishes to ensure that franchisees are not running into financial difficulties. Franchisees are in business to make a profit. If profits are not realized on a consistent basis, they may not stay in business. Franchised locations closing are not good for the brand and for the system as a whole. Good franchisors wish to protect the integrity of the brand and therefore need to be aware of any franchisees in financial difficulty so that they can be proactive in assisting to correct the situation.

Third, franchisors will wish to establish key metrics and benchmarks for the system as a whole. These system benchmarks and averages can be provided back to the franchisee so they can measure their individual performance as it compares to the system as a whole. It will identify problem areas or items of potential improvement. As an example, you might be having a 35% employee turnover, but other franchisees are averaging 20% employee turnover. This provides the franchisee with an area to focus on to improve the performance of the business.

Fourth, the franchisor wishes to monitor overall business trends. Are certain categories of retail items dwindling in sales and needing to be replaced with another product category? Are the average dollar amounts per transaction shrinking?

This may require adjustments to the offering. Is there an unaccounted disappearance of inventory that may require implementing greater security controls? Without monitoring key business metrics and having a basis for comparison, it is difficult to make these and other business decisions.

Franchisees are not just required to report to the franchisor. Similar to any business owner, the franchisee is also required to submit regular reports and financial submissions to the government. Monthly or quarterly, there may be GST/HST reports, payroll reports and remittance of taxes, workers compensation and employment insurance. Although it is the franchisee’s legal responsibility to submit these payments, some franchisors will require copies so that they can ensure that all required payments have been made. Failure to pay government remittance
and taxes could result in the government stepping in and closing the business. Again, the franchisor has a strong interest in and commitment to ensuring that the brand continues in the location.

Finally, franchise systems need to be able to monitor their franchisees for system consistency. The product and service offering needs to be consistent no matter the location. It is through consistency that a brand is created. Thus, there may be required reports regarding the quality of the product or service being provided. A report regarding customer complaints and how they were handled is also regularly provided to the franchisor.

Reporting is a necessary part of being in a franchise system. It may feel sometimes like “big brother” is watching, but ultimately it is in the franchisees’ best interests as it protects their investment. It is in everyone’s interest that no one be allowed to ‘cheat’ the system and all are paying their fair share. All franchisees can benefit from reporting and getting feedback as to how they are doing relative to others. This is one of the biggest benefits of a franchise, when compared to opening as an independent. You, the franchisee, have resources that simply are not available if you were on your own. Providing the franchisor with information can assist in improving operations across the system, including early recognition of issues such as internal theft, excessive operational costs and changing market trends – all of which require corrective action.

Study Questions

1. Most franchise agreements require franchisees to submit regular reports. These reports are usually:
   a) Submitted on a monthly basis
   b) Submitted in person as part of an elaborate presentation
   c) A summary of the franchisee’s financial reports, sales metrics and/or profit and loss statements
   d) Both a) and c)

2. True or false: Franchisors require regular reporting from their franchisees because it is in everyone’s best interests to be aware of what is happening throughout the franchise system.
   a) True b) False

3. Franchisees are usually also required to submit reports and documentation to the government. What are some of these submissions?
   a) GST/HST reports
   b) Employment insurance
   c) Payroll reports
   d) All of the above

4. There are benefits to regular franchisee reporting. They include:
   a) Protecting franchisees’ investments through early recognition of any problems or issues
   b) Feedback and benchmarking
   c) Both a) and c)

Answer Key: 1) d 2) a 3) d 4) c
When a franchisee enters into a franchise agreement, they acquire specific rights, but they also commit to certain obligations. The franchisor/franchisee relationship is largely based on good faith. The franchisor trusts the franchisee will comply with the franchise agreement. In most situations, this is the case, but not always. Sometimes mistakes will happen. In more unusual circumstances, a franchisee may intentionally underreport sales or not follow the system in some way. To address this, franchise agreements will usually give the franchisor the right to conduct an audit on the franchisee in question to ensure compliance with obligations.

Most franchise agreements will allow the franchisor to perform a financial audit on its franchisees. The franchisor may sometimes decide to do a financial audit at random; more frequently, it will choose to conduct one in the unusual circumstance where the franchisee fails to submit required financial reports. The franchisor may also do an audit if it suspects that the royalties being paid by franchisees are not aligned with the actual amounts that are due. Franchisees not paying their fair share jeopardize the financial stability of the franchisor, and can hinder the franchisor from meeting its obligations to its franchisees, shareholders, and employees.

In doing an audit, the franchisor will look at sales as they are reported on monthly reports to the franchisor, and compare this to sales as reported in the point-of-sale system, as indicated through sale invoices, government tax filings, inventory turnover, and bank deposits. All of these numbers should be aligned and indicating an equal level of sales. If inconsistencies are found, this could be an indication of accounting errors or intentional underreporting of sales in order to avoid paying royalties.

A financial audit may be the only way to determine what royalties are due and payable if such royalties are a percentage of sales. If no royalties are being paid, or in the event that the audit uncovers that the franchisee underpaid its royalties and other financial obligations, the cost of the audit is typically charged to the franchisee. Allowances are made for error, usually up to three per cent. Where there is an underreporting of sales greater than three per cent, the franchise agreement will generally dictate that the costs for the audit shall then be charged to the franchisee, along with payment of outstanding royalties due with interest.

If underreporting of sales is an ongoing issue, it may be grounds for termination of the franchise license. This can be avoided by the franchisee simply fulfilling their financial obligations to the franchisors when due. Franchisors have a variety of ways of uncovering underreporting. Be confident in knowing that at some point the franchisee not paying the appropriate amounts will be caught out.

Obligations of the franchisee go beyond simply financial – franchisees are also required to follow the franchise operating system. The system is designed to create a consistent customer experience, as it is through consistency that a brand is created. In the interest of preserving the brand, the franchisor will also conduct operational audits. These may be formally announced meetings with the franchisee involved, or they may be done unannounced, sometimes through a mystery shopping program. Things that are looked at in an operational audit may include the following:
• Location cleanliness and appearance
• Use of logo and advertising materials
• Local advertising
• Use of approved products and suppliers
• Product or service quality and presentation
• Speed of service and delivery
• State of equipment and proper usage
• Confirmation of proper licenses and insurance
• Compliance with required labour laws and minimum wage
• Required hours opened for business

Good franchisors do operational audits to ensure that the system is being implemented consistently in all locations. Franchise systems need to be able to monitor their franchisees for system compliance to ensure brand protection. Strong franchisees welcome the audits, knowing that it is protecting their investment. Audits may uncover such things as weak internal controls, higher-than-average operating expenses, and possible internal theft. Such feedback from an audit, either financial or operational, can provide valuable information that will assist in improving the business.

Periodic audits are an important part of any franchise system. Often, compliance problems are the consequence of innocent mistakes. Where there are issues, audits can identify them and corrections can often be made to improve profitability. If the compliance issues are ongoing, it may be grounds for termination of the franchise. It is important that all franchisees protect their investment in the system by meeting their financial and operational obligations.

Study Questions

1. An audit is generally performed by a franchisor when a franchisee:
   a) Is operating successfully and meeting all obligations as set in the franchise agreement
   b) Fails to submit required reports
   c) Is suspected of paying royalties not aligned with the actual amounts due
   d) Both b) and c)
   
2. True or false: When a franchisor conducts a financial audit on a franchisee, there is no allowance made for errors in accounting/reporting.
   a) True b) False

3. The franchisor may also carry out operational audits on its location. Things that may be looked at during an operational audit include:
   a) Cleanliness and appearance of the location
   b) Use of approved products and suppliers
   c) Confirmation of proper licenses and insurance
   d) All of the above

4. True or false: Periodic audits, both financial and operational, play an important role in the success of any franchise system.
   a) True b) False

Answer Key: 1) d 2) b

CFA Guidebook Series: The Fundamentals of Franchising
Despite best efforts, there may come a time during a franchise partnership where franchisee and franchisor disagree. This is a reality in any relationship. Maybe you disagree with how national advertising dollars are being spent, or think new menu items being introduced will not sell well in your market. Many franchisors have a franchise advisory council where issues can be dealt with as a group.

Another approach is to simply talk to the franchisor. Many issues can be resolved by open communication between the parties with mutual respect for each other’s viewpoint. Set up a face-to-face meeting and present your case, but at the same time keep an open mind and listen. You may not have heard the research and logic behind the decision. Similarly, the franchisor may not have fully taken into account franchisees’ firsthand experience.

If agreement still cannot be reached, there are options. The Canadian Franchise Association (CFA) has an Ombudsman program, a free program available to all franchisees and franchisors in Canada. The Ombudsman will listen to one or both sides and try to facilitate communication. All discussions are completely confidential and done informally by phone. Contact the CFA Ombudsman at 866-443-8255.

A franchise agreement will typically address dispute resolution. The agreement may make reference to both parties being required to go to mediation to resolve differences. Mediation is an effective way to resolve disputes that is quicker and often less costly than going to court. The costs of mediation are shared by both the franchisee and franchisor and will vary depending upon the complexity of the disagreement. The process is formal and involves both parties meeting face-to-face with a neutral third party facilitating discussions to reach an acceptable agreement. Mediation is voluntary and non-binding. Find a neutral mediator that both the franchisee and franchisor agree upon.

If an agreement cannot be reached through mediation then arbitration becomes the next step to resolving the differences. Whereas mediation is non-binding, arbitration is binding and may result in a decision that is not acceptable to one party. It is a quicker and more efficient process than going through the courts and often less costly. By going to arbitration, the parties agree to give up their rights to pursue the dispute in court.

The arbitration must be agreed to by both parties. The arbitrator is ideally someone who understands law and franchising, often a lawyer or judge. The franchisee and franchisor typically must agree on an arbitrator. If an agreement can’t be reached then often the franchisee and franchisor will each pick an arbitrator and the two arbitrators then pick a third. The arbitration process is then conducted before a panel of three arbitrators. This will result in the costs, shared equally by the franchisee and franchisor, being as much as three times more as that of a single arbitrator. The arbitrator(s) listen to both sides and review all evidence. This may take several days or several weeks. Once all material is reviewed, the arbitrator(s) deliberate before making a final decision. The entire process may take several months.

The last method of dispute resolution is going to court. In some cases this may be the only way to find a solution, although it is the most costly and can take years to resolve. This method is one both franchisees and
Disputes are often a part of any long-term relationship. Good franchisors are sensitive to individual circumstances but make decisions for the system as a whole. Communication and discussions often resolve many issues. If not, it is prudent to understand the resolution alternatives.

Study Questions

1. The first method of dispute resolution a franchisee or franchisor should explore is:
   a) Mediation
   b) An open discussion
   c) Legal proceedings

2. The costs involved in mediation, arbitration or a court case are paid for by:
   a) The franchisee
   b) The franchisor
   c) Splitting the cost equally between the franchisee and franchisor

3. Mediation is a non-binding process, while the results of arbitration are binding. True or False?
   a) True   b) False

4. Going to court is the fastest and cheapest way to resolve franchisee-franchisor disputes.
   a) True   b) False

Answer Key: 1) b  2) c  3) a  4) b
At some point during the franchise relationship there may come a time where a decision is made to bring the franchise partnership to an end. The franchise licence term may simply come to an end and you may decide not to renew, or there could be other reasons why an end of the franchise agreement would take place.

All franchise agreements make reference to defaults. This is where you are in breach of the franchise agreement. The franchise agreement has obligations that you must meet, and to fail to meet these obligations will cause financial loss to the franchisor or cause damage to the franchise brand.

Some defaults can be corrected or “cured.” Examples would be non-payment of royalties or fees, non-compliance with standards, or failing to submit reports and financial statements. In these cases, the franchisor will give you a reasonable amount of time to cure these defaults, usually 14 days. If you need more time due to unusual circumstances, let the franchisor know and they will often grant extensions. If you still fail to cure the default, then the franchisor has the right to terminate the agreement. Through your actions, you will decide whether or not the agreement comes to an end.

There will be some instances where the franchisor has the right to terminate the franchise agreement without notice due to your actions. It may be that you have charged a security interest or sold the business without the franchisor’s permission, intentionally provided false or misrepresented financial statements, or you have given away confidential information. It may be that your company has gone bankrupt, into receivership, or simply been abandoned. These circumstances all reflect a failing business. It is important to remember that a good franchise system will usually minimize your risk, but does not make you immune. The nature of business is that there will always be a chance that the business will fail for a variety of reasons. Ideally, you and the franchisor have been communicating and dealing with the shortfalls of the business long before it gets to this stage.

Know that, in the event that the business is failing, you have choices. One is to sell the business and transfer or assign the franchise licence agreement to a new franchisee. This is a far better choice than letting the business fail, as it allows you to recoup some, if not all, of your investment. You may also choose to transfer the franchise agreement because the business is doing well and you wish to recoup a return on your investment. You may want to retire, there may be a partnership breakup, or you have simply decided you want to do something else. Understand that a franchise is not a life sentence. Although the term of the franchise agreement may say 10 years, you may choose to sell your business and get out sooner.

When selling your business and assigning the franchise licence, be sure to check with the franchisor to see if they have a resale program. They may be working with qualified buyers who have an interest in your location. A transfer involves several requirements. The franchisor will want to approve any advertising that you do for the business sale. The franchisor must approve the new franchisee, all royalties and fees must be paid, and the franchise must be in good standing. There will typically be a transfer fee to pay to the franchisor, often a percentage of the current franchise agreement and, in some cases, a percentage of the total business sale price. The transfer fee will typically be used.
to cover the franchisor’s administration and training costs to facilitate the transfer to the new franchisee. Note, in many franchise agreements there will be a clause where the franchisor has the right of first refusal and may choose to match the purchase price and buy the business themselves.

There are several unique circumstances where a change in ownership takes place. In some cases, you may decide to assign shares to potential investors or even key employees. The franchisor will typically want to approve the new shareholders if it is a substantial share transfer and will definitely need to approve the assignment of shares if it changes controlling interest in the company. There may be circumstances where you transfer shares to family members. Often franchisors will allow this to take place without a transfer fee. There may be the harsh reality of death or permanent disability. The franchise agreement will often contemplate these situations with terms allowing the estate a reasonable amount of time to transfer the franchise to a new franchisee and recoup the investment. During this time the business must continue to operate and the franchisor will often step in and manage or arrange the management of the business for a fee.

When the franchise is terminated, you will be required to immediately cease doing business under the brand. You will be required to return the confidential operation manuals and pay all outstanding fees and payments to the franchisor. In some cases, this may include future royalties that the franchisor would have earned if the franchised location had continued. Typically, you will not be able to operate a competing business within a defined geographical area for a specified period of time.

Franchise relationships will come to an end for a variety of reasons. In many cases, it is you and your actions that will dictate if it will happen and how. In other circumstances, it will be events outside of your control. When it is time to bring the franchise relationship to an end, review your franchise agreement to have a full understanding of what the terms and conditions are for your agreement in these various scenarios. This will allow you to maximize your return on investment, or alternatively minimize your loss.

Study Questions

1. A default is:
   a) When a franchisee is in breach of a franchise agreement
   b) Something that all franchise agreements make reference to
   c) Both a) and b)

2. When selling your business and transferring the licence to a new franchisee:
   a) You should advertise and conduct the sale without notifying the franchisor
   b) You must allow the franchisor to approve the new franchisee
   c) You will never pay a transfer fee

3. If your franchise agreement is terminated, you can open a competing business next door right away. True or False?
   a) True   b) False

4. Franchise relationships can come to an end for a variety of reasons. True or False?
   a) True   b) False

Answer Key: 1) c  2) b  3) a  4) b
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