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LAW FIRM

F R A N C H I S E L A W

Guide to Franchising Your Business

This guide is designed as a helpful template for business owners considering franchising their business. Cut through to the key information and determine which steps you need to take to franchise your business. This is a general summary to help point potential franchisors in the right direction, it does not represent legal advice and should not be relied upon as such.

Reidel Law Firm works with franchisors and franchisees around the world. We can help take your US franchise concept overseas or your overseas franchise concept to the US, the largest economy in the world. We strive for excellence in both the legal and business fields. Our firm offers advertising/marketing, public relations, and wealth/asset protection services in addition to addressing the legal needs of small businesses. We rely on our values of efficiency, accessibility, and excellence to help business owners achieve prosperity and security in a fast-paced, challenging economy. You can find out more about our legal and business services at:

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Guide to Franchising your Business

Part 1: Intro to Franchising

Business Model Franchising

A franchise is a business model that involves one business owner licensing a business model and/or other intellectual property (IP) to an independent owner. Franchising involves a business model, IP, and control of the franchisee. Ideas alone cannot be a franchise nor are they franchiseable. Only businesses with a successful track record and a well developed business model should consider franchising.

Some confuse franchising with the similar but legally distinct practice of licensing. Licensing allows for the use of a brand or trademark but does not involve a business model or control. Business model franchises include McDonald's, Burger King, and SportsClips. Examples of businesses that license include Disney, NASCAR, and Betty Crocker.

There are many advantages from which a franchisor can benefit when deciding to franchise their business model, including maximizing growth, lowered operational costs, and additional revenue streams. Franchising allows a business to expand quickly with much lower overhead than opening corporate owned units because the franchisee takes responsibility for opening and operating the unit. In addition, the franchisee operates independently, which helps lower the operational cost per unit for the franchisor as they are allowed to focus on better marketing, IP innovation, and improving the business model. As the franchise system grows, the franchisor will have the opportunity to benefit from many revenue streams including royalties, franchise fees, and even the potential to license some of the products or IP outside of the franchise system.

Of course, a few distinct disadvantages for potential franchisors often accompany these great advantages. Upfront investment costs are considerable and should not be taken lightly. The direct cost of hiring consultants, attorneys, and even additional staff can easily run into a six-figure expense. Also, franchisors must factor in the amount of time one will need to spend outside of their already existing business. Potential franchisors will need to develop and create operations manuals, marketing manuals, examples, and corporate guidelines before they entertain their first franchisee. Additionally, a hefty investment in the infrastructure is necessary to maintain and manage your franchise network. From royalties to marketing to bulk material purchases, all of these aspects need to be calculated weekly, if not daily. Each factor must be evaluated before a potential franchisor begins offering franchises.

Business Model Franchises:



Licensed Products:



Part 2: Building a Franchise System

You must prove the success of your franchise system over a reasonable period of time by operating your own units as well as demonstrating that others can replicate your success in pilot operations. Potential franchisees will want to see well drafted operations manuals and systems in place in your existing units. These should cover all aspects of the business and demonstrate your ability to plan well and tailor the system to your market to achieve success. Furthermore, others should be able to replicate your system. Franchisees need to know that by following your system, they can achieve success. A key question to ask to determine you are ready to franchise is whether or not your system is sustainable without you. Often this is one of the hardest hurdles for entrepreneurs to overcome. Many are indispensable to their own businesses, which is not a good fit for franchising.

Standardization is the key for the operations manual of any business. As you outline your business's standard operating procedures, be sure to write with everyone in mind. The manual should be written in a manner that is easy to understand, even for people not familiar with your industry. The first part of your operations manual should be the introduction, which explains how to use the manual and what other training materials or contact persons are available. It is good to explain the basic mission, history, and principles of the company here as well. In addition, be sure to include the confidentiality agreement that your franchisee signed as a potential franchisee or with the franchise agreement. The operations manuals are your business's property, and they should not be disclosed or used unlawfully.

After the introduction you will likely want to organize the operations manual in chronological order. Therefore, you will present the most relevant information to the franchisee as it occurs. For example, many operations manuals lay out the pre-opening period week by week and explain what every franchisee should have accomplished and how they should go about doing it. Oftentimes, this period runs from six to ten or more weeks. Throughout this period, franchisees will have milestones that they will need to address and meet if the franchise unit is to be successful.

The bulk of your operations manual will consist of information detailing the various office policies, cleaning procedures, opening/closing procedures, security systems, the many administrative requirements, and even sales and pricing. These typically require hundreds of pages, as you should not leave any stone unturned. A well drafted and thorough operations manual is essential to keep your franchisees standardized and high quality. Some franchisors next choose to offer comprehensive guidance on employing staff for the franchisee's unit. Sometimes this results in legal obligations for the franchisor, so be sure to have a franchise attorney review this section and its implications. This chronology will often contain the franchisor's corporate training requirements.

You will need to offer ongoing training and also monitor compliance with your standard operating procedures to ensure the best quality of your franchisees. Many potential franchisees will often have little to no experience in the industry or running a business. Training and support are essential components of a healthy and profitable franchise system. Franchisors will need to create a comprehensive training program explaining how the franchisee is supposed to operate and the guidelines therein. Initial training of franchisees can be a very intensive project as you

begin to recruit more franchisees. Ongoing support will also become a more important factor as franchisees begin to grow in number.

Typical franchise training programs involve a tour of the premier franchisor operation, classroom or video training sessions, and several on-site training sessions at one or more existing franchise units. Touring the operations and introducing key corporate personnel are also important parts of training. After corporate training, some franchisors go the extra mile and offer a few days to several weeks of assistance and training at the franchisee's location. This gives the franchisor the ability to monitor their new franchisees' performance as well as help train new employees properly. Sometimes franchisors will begin to neglect or withdraw their ongoing support to franchisees as the system grows, but this practice will negatively affect standardization and your franchise system. Do not be tempted to cut expenses by dropping support and training — it will always cost more in the long run.

Without a secure brand, a franchise cannot exist. Owning and having proper documentation for all of your IP is essential in order for you to build your franchise system. Your intellectual property will likely include one or many trademarks, copyrights to inter-company documents, patents for any inventions developed, and possibly trade secrets. Each will have its own requirements for registration and protection from internal and external threats. As a franchisor, you will have an obligation to your franchisees to take necessary actions to protect against anyone who may damage the brand. Having rock solid non-disclosure agreements before you begin interviewing and entertaining potential franchisees is exceedingly important. I have seen instances where franchisors are very trusting, do not feel the need for an NDA, and have ended up losing potential franchisees, parts of the marketing, and/or proprietary process after a potential franchisee decides to use that knowledge and start their own competing business.

Within your franchise system, you will need to keep franchisees from damaging your IP either intentionally or inadvertently. For instance, let's take the example of a trade secret that allows you to keep a proprietary recipe, invention, or process secret given that it has value and is actually kept secret. Should one of your franchisees accidentally post your trade secret recipe online, you will lose the ability to bring legal action against those who use your now not-so-secret recipe without your permission. As you build your franchise system, ensuring the proper employment and IP agreements are in place along with a way to monitor brand use and misuse are essential safeguards to maintaining a successful franchise.

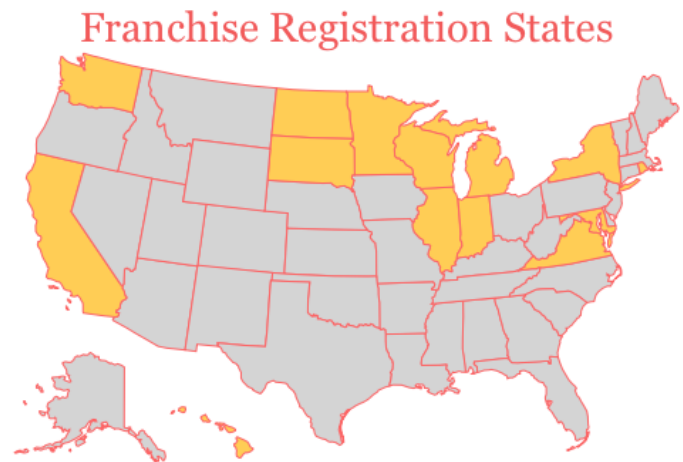
Part 3: Franchise Agreements, Franchise Disclosure Documents, and the Law

Franchising is subject to a myriad of laws — federal and state laws vary and require much attention to detail as you begin preparing your franchise offering documentation. Federal and state law govern franchises in tandem. The Federal Trade Commission rules lay out the minimum rules and documentation required for franchises. States are allowed to place greater requirements and rules on franchises, some of which do, including California, Minnesota, New York, and Maryland. As your franchise system expands you will need to be careful not to offer franchises in states where you have not met the state rules for documentation and potentially for registration.

Federal law centers around what documentation must be created and provided to potential franchisees. This documentation is called the Franchise Disclosure Document (FDD) and requires several hundred pages for even the most basic of franchise systems. The FDD must be completed before any franchise may be offered to the public. As a franchisor you will need to know the FDD and each of its 21 Items very well. The purpose of the FDD is to provide prospective franchisees with information about the franchisor, the franchise system, and the agreements they will need to sign to become a franchisee. Importantly, the Items include Business Experience, Initial Fees, Other Fees, Franchisee's Obligations, Franchisor's Obligations, and audited Financial Statements. The FDD is a comprehensive document that you should have an attorney draft or review before you begin sending it out to potential franchisees. Don't forget that you will need to update or redraft your FDD every year to stay in compliance. In addition to requiring an FDD, the federal rules also mandate that the franchisor provide the latest FDD to potential franchisees at least two weeks before any binding documents are signed.

After verifying compliance with the FTC rules, you must ensure that you comply with any individual state rules in states where you offer a franchise. Many states like Texas merely require a franchisor to sign an affidavit promising compliance with the federal rules. Other states require that a state specific FDD be prepared and submitted to a state agency for registration and approval. These state laws can become overwhelming rather quickly for the franchisor who attempts to draft, file, and register their FDD without professional help. Penalties for misfiling or failure to file range from monetary fines to allowing franchisees to repudiate any agreements signed during the franchisor's non-compliance.

The Franchise Agreement (FA) is the written, binding contract between the franchisor and franchisee. The FA details the obligations, conditions, and requirements between the franchisor and franchisees. This is the fundamental contract for a franchise relationship. Unlike the FDD, there is no standard format or requirements for an FA. Generally, the franchise agreement will specifically include the franchise fees, the duration of the contract, territory rights, obligations



for the franchisee (which can widely vary), and obligations of the franchisor to the franchisee. As a franchisor, you will need to lay out the franchisee obligations carefully as well as have a mechanism for monitoring franchisee compliance. Franchisee obligations usually range from the typical royalty percentage (and how it is calculated and paid) to the equipment needed to run the franchise to comprehensive guidelines on how the franchisee is to employ workers. Every franchise system is different and will have unique needs, which you will inevitably need to adjust and expand as the system grows.

Beyond the documents that establish the franchise relationship, several states have laws that govern the ongoing renewals and terminations between franchisor and franchisees. Some of these states include California, Minnesota, Virginia, and Wisconsin. Most of the states that regulate the franchise relationship prohibit the franchisor from terminating the franchise agreement without “good cause.” Usually the state also allows the franchisee to cure the default and require written notice before termination can be executed. Similarly, many of these same states also prohibit the franchisor from refusing to transfer a franchise without good cause. Renewals can also be subjected to certain state restrictions. Importantly, California, Illinois, and several other states require a franchisor to give written notice of a non-renewal of a franchise. There are many other potential state laws that may govern how you interact with your franchisees in various states. It is crucial for you to be fully aware of how these laws will affect your franchise system and to completely prepare for ongoing compliance.

FDD 21 Items:

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- | | |
|--------------------------|--------------------------|
| 1. The Franchisor | |
| 2. Business Experience | 13. Trademarks |
| 3. Litigation | 14. Patents, Etc |
| 4. Bankruptcy | 15. Obligation to |
| 5. Initial Fees | Participate |
| 6. Other Fees | 16. Restrictions for |
| 7. Estimated Investment | Sales |
| 8. Restrictions | 17. Renewal, |
| 9. Franchisee Obligation | Termination, Transfer |
| 10. Financing | 18. Public Figures |
| 11. Franchisor | 19. Financial |
| Assistance | Performance |
| 12. Territory | 20. Franchisee Info |
| | 21. Financial Statements |

Part 4: The Franchise Business Plan

Once you have made the decision to franchise, you will need to begin preparing for the documentation and decisions that must be made to get your franchise system off the ground. The first basic step to take is to draft a franchise business plan. To get started on your own franchise business plan, click [HERE](#) for our Franchise Business Plan Template. The franchise business plan will serve as your roadmap to achieving your vision for your franchise. A franchise business plan will also be required if you want to secure third party financing. You will be able to use much of the business plan from your existing business as you expand it into a franchise system. This will also allow you to gauge what worked and what didn't in your original business plan.

There are four major sections of the business plan, and they consist of the executive summary and introduction, management (operations), marketing plan, and financial analysis. The introduction should be an informative section that details the business, its products, and the market. If you have ever carried out market analysis on your current customer demographics and your geographic market, this will be the place to expand and use that information. It will also be helpful to include data on your competition both for your existing business and any future competitors of your franchise system. It is also important to identify the unique challenges you have faced in your business and how you have overcome those challenges to be successful.

Next, the business plan will need to explain how the franchise system will be managed. Detail the management positions and why those positions are needed for the franchise system. This section will also explain how you will monitor and manage your system of franchisees effectively. You should also address any particulars about your operation, licensing, facilities, regulatory issues, and the systems your franchise will have in place. This section will likely change as the franchise system grows and the best management practices for your system become apparent.

After management will be the marketing plan. Marketing a franchise system is vastly different from marketing your products or services. You will need to explain how the franchise will market itself to potential franchisees as well as how the franchise will market its products or services to customers. Outline all of your marketing and advertising plans for reaching customers and potential franchisees. Each will require different approaches and you must accurately target the demographics appropriate to each. Be sure to also discuss the value of your products or services and how they offer a unique advantage to your franchise.

Finally, your financial analysis will detail the capital costs and the projected finances of your franchise business. This section will include yearly financial statements, cash flow projections, and balance sheets. This data details how successful your business has been and why it is a good candidate to franchise. Use the data from your existing business to guide your projections as the franchise system grows. The more financial details you have, the better your projections will be. You will also need to include a complete cost-benefit analysis of the startup costs for the franchise system. Explain the capital needed to cover operations until you begin making a profit. Also note where this capital will come from, especially if you are bringing in partners.

After you have your business and marketing plan on paper you will next need to review your business's financials. Most states require three years of GAAP (generally accepted

accounting practices) accounting to be included in your FDD. You will need to have a CPA audit your financials and verify that the numbers provided in the FDD are GAAP certified and true. If you have been in business for less than three years, some states will allow ongoing compliance with some additional statements in the FDD but generally, a business will not be ready to franchise in such a short period of existence. If you do not have an outside auditor check your financials each year, start now. Including this practice will make franchising much easier as you will already have audited financial statements available at the outset. Otherwise receipts, payroll, and all accounts will have to be audited going back at least three years.

In addition, you will need to complete the FDD, FA, and your IP before offering a franchise for sale. These have been discussed previously so it is not necessary to rehash what those are and why you need them. It is strongly recommended that a potential franchisor bring in a franchise consultant and a franchise attorney to help navigate the ocean of rules, regulations, and required paperwork. A good franchising consultant will help draft and review your operations manuals, your franchise agreement, and your system's structure. Your franchise attorney will help draft these documents and ensure your compliance in the states where you will offer the franchise for sale. Both will be an important part of making your franchise a success.

Part 5: Costs to Franchise

The cost to franchise your business can range widely. Costs will often be from \$20,000 for barebones document drafting to \$150,000 for a full franchising consultation. These costs reflect both the amount of work involved in franchising and the potential reward for the right business. The costs listed here are very general, and it is always recommended that you obtain quotes from several different providers. Initially, you will likely need a feasibility study, a review of your business, and marketing plans. Depending on your industry and the extent to which you study your market demographics, this will generally cost around \$10,000. The next step involves finishing the operations manuals and training materials for the new franchisees. These must be very detailed and reviewed carefully, and this step usually costs around \$15,000 to \$30,000. Preparation of the FDD for both federal and state laws can range from \$20,000 to \$40,000.

As is readily apparent, the costs of franchising a business quickly add up. These procedures represent just the bare minimum required to get started. Other costs that may be necessary include franchise sales training, applying for registered trademarks or other IP, creating a new entity for the franchisor business, and even advertising to potential franchisees. Whatever your path to franchising and whatever the cost, be sure to carefully plan how you will franchise your business. Don't be afraid to get more than one quote for costs or to negotiate prices with consultants and attorneys.

Part 6: Next Steps

Next Steps

Creating a Successful Franchise

STEP 1



Draft or Review your business and marketing plans. Does it cover both your business and the potential franchise system? This will be an essential guide as you build your franchise system.

STEP 2



Start GAAP (generally acceptable accounting practices) now! If you are intent on starting a franchise system now, you should go back at least 3 years and audit your financials using GAAP.

STEP 3



Research similar franchise systems and learn as much as you can about your industry. Find out what system works best in your industry and improve it.

STEP 4



Find the right team. You need a strong team to build your franchise system, call in the experts.

CONCLUSION:

Start preparing for your future today. Don't let another year pass without preparing to build a successful franchise out of your business. Call Reidel Law Firm today to get us on your team!

We hope you enjoyed Reidel Law Firm's Guide to Franchising Your Business. Share your franchising success stories with us at: schuyler@ReidelLawFirm.com. Be sure to check out our website and wealth of info on franchising and other business topics at: ReidelLawFirm.com.

Appendix A: List of Helpful Resources

Franchise Organizations

International Franchise Association (IFA)

<http://www.franchise.org>

American Association of Franchisees and Dealers (AAFD)

<https://www.aafd.org/>

Franchise Expos

Franchise Expo South (January 24-26, 2019) Ft. Lauderdale, FL

<http://www.franchiseexposouth.com>

International Franchise Expo (May 31- June 2, 2018) New York City, NY

<http://www.ifeinfo.com>

West Coast Franchise Expo (November 1-3, 2018) Los Angeles, CA

<http://www.wcfexpo.com>

Small Business Resources

Small Business Administration

<https://www.sba.gov>

Small Business Development Centers

<https://www.sba.gov/offices/headquarters/osbdc/resources/11409>

Appendix B: Reidel Law Firm Upcoming Events:

Offshore Technology Conference (April 30 - May 3, 2018), Houston, TX

<http://2018.otcnet.org>

International Franchise Expo, Reidel Law Firm International Delegation

[New York, NY \(May 31 - June 2, 2018\)](#)

Appendix C: Selected Partners and Friends of Reidel Law Firm:

David Lee, C.F.E., [All-Star Franchise Development, LLC](#)

Franchise Consultant and Broker

Dr. Joseph Michels, Ph.D, P.E., C.P.L. [Solomon Bruce Consulting, LLC](#)

Business Consultant, Logistics, and Government Procurement Expert

Jason Killough, C.F.E., [The Entrepreneur Authority of Texas](#)

Franchise Advisor and Broker for Franchisees