

International Franchising: Selecting a Country and a Franchisee

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With the ever-increasing globalization of trade, a growing number of United States businesses are expanding into international markets. Franchisors are particularly well-suited to benefit from international opportunities. Before committing to international expansion, however, a franchisor should carefully select appropriate franchisees and countries for development.

Whom to Select?

When selecting an international franchisee, a franchisor should consider whether the prospect satisfies the following criteria:

- Knowledge of the general market in the target country, the franchised business, the real estate market and franchising in general.
- Adequate financial and management resources.
- Language and communications capabilities.
- Experience with businesses from the United States.
- Access to sites for franchised outlets.
- Experience with other franchise systems.

Can the Franchise System be Adapted?

Critical to the success of international expansion is the adaptability of the franchised system, including the products or services, trademarks and business format, to foreign markets and cultures. For each target country, a franchisor should consider:

- Standard of living
- Economic stability
- Cultural factors and tastes
- Demographic factors
- Religious beliefs

- Dietary customs and restrictions
- Linguistics/language
- Presence of similar products and services
- Trademark translations
- Adequacy of workforce

Where to Expand?

The overall concerns in international expansion are the adaptability of the franchise system to the target country, the relationship between the United States and the target country and the suitability of the target country for franchise expansion.

Political/Commercial Relations

Franchisors also should gain an understanding of the political and commercial relations between the United States and the target country. Treaties and other international agreements, such as the United Nations Convention on Contracts for the International Sales of Goods, may affect taxation, investment and trademark matters. The franchisor should also determine whether the United States has an embargo against the target country. The United States has enacted laws that may require the franchisor to do additional due diligence regarding the background of prospective franchisees. For example, Executive Order 13224 prohibits transactions with suspected terrorists and those associated with suspected terrorists. A franchisor also must take care to comply with laws such as the USA PATRIOT ACT and the Foreign Corrupt Practices Act (FCPA). Accordingly, the franchisor should conduct a detailed background check, check the lists provided by government agencies in the United States that identify individuals with whom companies cannot do business and require franchisees to certify that they have complied with such laws.

Suitability of the Target Country

Evaluating the suitability of a target country's market for the franchise program should focus on:

- **Methods of Distribution.** The existing methods of distribution for similar products or services and the prevalence of franchising as a method of distribution.
- **The Real Estate Market.** The issues posed include: site acquisition costs, construction and remodeling costs; availability of suitable sites; local laws and ordinances, such as zoning and usage limitations; restrictions on changing the character of buildings; time required to develop and equip sites; and access to sites for delivery of products.
- **Sources of Supplies.** A franchisor should determine the general availability of furnishings, fixtures, equipment, products and supplies in the target country and whether there are any import restrictions on these items. When considering importing, as opposed to sourcing locally, a franchisor should consider cost (including any applicable tariffs or duties), quality, reliability and the necessity and cost of safeguarding trade secrets. Importing items or licensing target country suppliers may enable the franchisor to gain greater control over the franchisee.

- **The Labor Market.** Local labor laws and labor unions, as well as other employment obligations and restrictions (especially any restrictions that bear on employee termination or its cost), can greatly impact the suitability of a target country. The availability of potential employees with requisite training and skills in the target country also is very important.
- **Credit Availability.** Because financial norms and practices vary among countries, a franchisor should carefully examine the typical lending practices in a target country, including those concerning cost, legal restrictions, availability of funds, typical lending terms and equity participation by lenders.
- **Ability to Convert Foreign Currency.** Restrictions on the conversion of currency, such as limitations on the amount permitted to be converted or the situations in which conversion is allowed, may affect a decision to expand.
- **Taxes.** The franchisor should review the tax structure in the target country, including any withholding taxes that must be paid on royalty and other fees.
- **Investment Considerations.** A franchisor should determine whether counter-trade or target country investment will be required to support the franchised business. The following questions are helpful in making this determination:
 - What products or services can the franchisor import from the target country to use in the franchisor's network or to sell to independent buyers?
 - Can target country currency be invested effectively in the target country?
 - Do residents of the target country possess convertible currency?
 - May some franchised outlets accept only convertible currency?
 - What are the economic conditions in the target country (*i.e.*, is the target economy growing and is the inflation rate manageable)?
- **Franchise Support Network.** A number of practical factors affect the establishment of a franchise system in a target country, including the communication and travel links and the necessity of maintaining management personnel of the franchisor in the target country.
- **Regulations and Laws.** A number of countries regulate franchise sales or the franchise relationship, which may greatly increase the cost of entry into a country. The franchisor should also review relevant laws relating to intellectual property, taxes, antitrust and the enforcement of contractual provisions, which may require the franchisor to make substantial adjustments to its standard form of agreements.

For more information about international franchising and development, please contact Franchise Group Chair Bob Smith at 202.719.4481.

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