Expanding the menu

Key considerations for growing your franchise abroad

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You spend your days working for Burgers & Burgers (or any other company that produces consumer goods and services) and your nights dreaming of taking the Burger & Burgers concept international. The concept is widely successful in the US and you and your teammates think it is time to expand beyond the borders and conquer new lands through franchising abroad. You have evaluated the methods for expansion and have decided the franchise model is best for you. From a legal perspective, here are some important issues that expanding companies are facing whether it is the first time they go international, or whether they are continuing to grow in new markets.

Trademarks

The “Burgers & Burgers” trademark is your identity. As one of the most valuable possessions of your company, you must ensure it is protected before you enter a new market in this world of globalized communication technology. There may be local companies already using similar names or issues with respect to the trademark being too generic in the local market. In some instances, there may be long delays in registering the trademark, which could delay your launch date in certain countries, especially if trademark registration is a condition to complying with franchise or foreign exchange laws. As such, some companies begin trademark registration two or three years ahead of time to anticipate any potential issues with their trademarks abroad. Your business planning must consider these challenges when opening a new market as they are critical to your long term success.
Franchising

Franchising is a popular concept. Franchising consists of finding a local partner with the appropriate local experience (i.e., the franchisee) to license the trademarks and know-how in exchange for a royalty payment, and the right to control part of how the franchisee runs the business. A franchise arrangement is designed to ensure that customers receive a consistently positive experience throughout the world. Franchising is highly regulated in various countries and those regulations tend to protect the franchisees. Franchise regulations generally require providing a franchise disclosure document to the prospective franchisee, registering with local authorities, or both. A franchise disclosure document is a document that summarizes in plain English (or sometimes it must be translated to the local language) certain provisions of the franchise agreement between the franchisee and franchisor, and certain information about the franchisor, including, for example, financial statements, the numbers of stores in operation, and the names and experience of executives in the franchisor’s team. Generally, the information to be included in the franchise disclosure document is dictated by the law of the country where the franchise will be ultimately located and there is little flexibility to deviate. A franchise disclosure document must be provided to the franchisee a certain number of days (generally 10 to 30 days, depending on the jurisdiction) before the parties execute the franchise agreement. In certain jurisdictions, franchisors must update the franchise disclosure document in the event there are any material changes to the information disclosed.

As mentioned, you may also need to register with local authorities. Registration varies from country to country and may include either registration of Burgers & Burgers as the franchisor entity, registration of the franchise disclosure document, or registration of the franchise agreement. Failing to abide by the local franchise rules of disclosure and registration may result in penalties and fines to the franchisor by local authorities, as well as rescission of the franchise agreement and reimbursement of fees to the franchisee. In addition to the US, many other countries are also regulated by franchising laws including Mexico, Canada, Brazil, Spain, China, Japan, Korea, Malaysia, South Africa, among others. Recently, Saudi Arabia, Argentina and Egypt have either passed franchise regulations or are in the process of considering new franchise regulations.

Due diligence

The most critical aspect of expanding internationally is choosing the right franchisee. You are entering into a long term relationship in a distant land and must understand the franchisee’s ethics, standards, philosophy in business, financial status, and overall suitability to deliver quality experiences to the customers. First and foremost, however, you need to undertake the diligence to confirm that it is legal to do business with this potential franchisee and that there are no sanctions or other legal barriers preventing you from working with the potential franchisee or any of its owners. As such, it is essential, among others, to understand who owns and operates the franchisee (up to the level of individual ownership, unless you are dealing with a government-owned entity or a publicly traded entity). Background checks are an important tool for identifying whether certain individuals have reputational risks or are politically exposed (i.e., have held or currently hold positions in the government), which would result in
additional due diligence, with the ultimate goal being to obtain sufficient assurances that the potential franchisee will not use any connections with the local government to obtain special treatment to operate the franchise, which could result in violation of the US Foreign Corrupt Practices Act. Similarly, it will be important to review all your third parties in these new markets, including your development and supply chain partners.

**Labor**

Before entering a new market, you must understand the local labor laws regardless of whether you will have employees working in that market. At a minimum, you should understand the labor pressures and regulations that your franchisee will face in running the business. In the event that you establish operations abroad to support your franchisees in a country or region, you will need to determine whether you will hire workers as employees or utilize independent contractors. Certain countries have very strict labor laws favorable to employees, which makes it difficult to terminate local employees even with cause. Other markets have very strong labor union or work council influence, and you will need to know the best approach in working with these organizations before signing new franchisees or hiring employees in that market. You must also consider whether your US employees will need work permits as they explore opportunities in new markets. For example, if your US employees visit the new market for negotiations or to provide training the local franchisees, will they need work permits? A well thought out labor strategy is essential for success in any new market.

**Business process**

Once you've identified a new market, it is important to understand the risks and obligations of doing business in that market. A well-crafted assessment will help you determine your strategy in entering the market and should evaluate political and currency risks, labor challenges, tax implications, real estate requirements, anticorruption risks, and other challenges. An assessment will guide your decision on how much local oversight and support your franchisees will need in that market. As a practical matter, the local market risks will impact whether you will need dedicated employees living and working in the new market or region, or to have teams traveling to the local market on a routine basis. Some of the risks and obligations to identify in a new market are, for example, whether such market has foreign exchange controls and if so, what options are available for the franchisee to remit payment to you outside of the franchisee's market. Some countries also have agency laws, which may extend to franchisees and limit your ability to terminate or fail to renew a franchise agreement without a termination payment to the franchisee. Additionally, Transparency International's Corruption Perception Index will help you get familiar with the local market whether you should consider having "feet on the ground." Finally, it is important to consider system modifications depending on the target market. For example, there may be a need to adapt your manuals, products (based on local taste), and ensure your supply system is ready and able to handle such new market.
Tax

Among others, three key basic issues to consider with respect to taxes are withholding taxes, permanent establishments, and transfer pricing. Generally, payments remitted outside a country in exchange for goods and services can be subject to withholding taxes imposed by the country from which the payment is remitted, and there are strategies to reduce such taxes under certain circumstances. As such, payments you receive from foreign franchisees may be subject to local withholding taxes. Your franchise agreement should set forth which party will be responsible for the amount of withholding taxes and for tendering payment to local authorities.

You can be deemed to set up a permanent establishment (PE) in a foreign country when you are deemed to have a fixed place of business in that country or when you have employees operating in-country who have the authority to conclude contracts on behalf of your company. Generally, however, simply entering into a franchise agreement with a local franchisee should not result in a PE. Having a PE could give rise to income or value-added tax liability in that country. As you might imagine, every country is different with respect to what constitutes a PE.

As you continue to expand internationally, you may decide to form affiliated companies in different countries and to subcontract such affiliates to provide certain goods or services to your franchisees. For US multinationals, income generated from these intercompany transactions can be subject to current US taxation as so-called "Subpart F income", even if the earnings are not actually repatriated to the US (i.e., even if the cash remains in the local affiliate). In addition, most countries require that these intercompany transactions be structured and priced on arm's length terms so that companies cannot simply avoid Subpart F or other problematic tax issues by eliminating the intercompany charge for these goods and services. A tax advisor can help you manage and in some cases eliminate such transfer pricing issues.

Data privacy

Knowledge is power. Data can bring substantial value to your company, but it can also present immense risk as you enter new markets. You should develop a global and market-level strategy for information management as you plan your expansion. It is essential to understand the local landscape for data protection, data breach requirements, insurance and other applicable regulations. In some markets the mishandling of data can result in criminal liability in addition to civil liability. As soon as you start exploring other markets, you will begin receiving personally identifiable information, at a minimum, from the potential franchisees, including their names, contact information, financial information, credit and background checks, and more. Once you begin operating in that country, you may also begin receiving personally identifiable information from customers, vendors and employees. It will be important to understand what the local market requires for data privacy and protection? Who owns the data, how is the data used, who stores and shares the data? Is consent required from the individuals or entities from whom you are collecting information? Is there a local enforcement agency? Will you need a Privacy Officer for the market? There are many information management questions to consider when entering a new
While your business team may be focused on burgers, it will be key to get their attention on data protection early on.

In conclusion, it is crucial to coordinate with experienced counsel that can help guide your team and look around the corner and down the street when it comes to identifying and solving the various aspects of expanding internationally, from trademark protection and choosing an entry strategy and a local partner, to tax planning, to understanding local laws that will impact your entry and control strategy. Appropriately planning and solving these and other issues will help you and your team be successful in your conquering of new lands.

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