

## 8.5: Franchising

### Learning Objectives

After reading this section, students should be able to ...

1. define franchising
2. explain the advantages and disadvantages of international franchising

Franchising is the practice of licensing another firm's business model as an operator.

Franchising is the practice of using another firm's successful business model. For the franchiser, the franchise is an alternative to building "chain stores" to distribute goods that avoids the investments and liability of a chain. The franchiser's success depends on the success of the franchisees. The franchisee is said to have a greater incentive than a direct employee because he or she has a direct stake in the business. Essentially, and in terms of distribution, the franchiser is a supplier who allows an operator, or a franchisee, to use the supplier's trademark and distribute the supplier's goods. In return, the operator pays the supplier a fee.

Similar to a licensing agreement, under a franchising agreement, the multinational firm grants rights on its intangible property, like technology or a brand name, to a foreign company for a specified period of time and receives a royalty in return. The difference is that the franchiser provides a bundle of services and products to the franchisee. For example, McDonald's expands overseas through franchises. Each franchise pays McDonald's a franchisee fee and a percentage of its sales and is required to purchase certain products from the franchiser. In return, the franchisee gets access to all of McDonald's products, systems, services, and management expertise.

In short, in terms of distribution, the franchiser is a supplier who allows an operator, or a franchisee, to use the supplier's trademark and distribute the supplier's goods. In return, the operator pays the supplier a fee.

Each party to a franchise has several interests to protect. The franchiser is involved in securing protection for the trademark, controlling the business concept, and securing know how. The franchisee is obligated to carry out the services for which the trademark has been made prominent or famous. There is a great deal of standardization required. The place of service has to bear the franchiser's signs, logos, and trademark in a prominent place. The uniforms worn by the staff of the franchisee have to be of a particular design and color. The service has to be in accordance with the pattern followed by the franchiser in the successful franchise operations. Thus, franchisees are not in full control of the business, as they would be in retailing.

A service can be successful if equipment and supplies are purchased at a fair price from the franchiser or sources recommended by the franchiser. A coffee brew, for example, can be readily identified by the trademark if its raw materials come from a particular supplier. If the franchiser requires purchase from his stores, it may come under anti-trust legislation or equivalent laws of other countries. So too the purchase of uniforms of personnel, signs, etc., as well as the franchise sites, if they are owned or controlled by the franchiser.

Franchise agreements carry no guarantees or warranties, and the franchisee has little or no recourse to legal intervention in the event of a dispute. Franchise contracts tend to be unilateral contracts in favor of the franchiser, who is generally protected from lawsuits from their franchisees because of the non-negotiable contracts that require franchisees to acknowledge, in effect, that they are buying the franchise knowing that there is risk, and that they have not been promised success or profits by the franchiser. Contracts are renewable at the sole option of the franchiser. Most franchisers require franchisees to sign agreements that mandate where and under what law any dispute would be litigated.

### KEY POINTS

- Essentially, and in terms of distribution, the franchiser is a supplier who allows an operator, or a franchisee, to use the supplier's trademark and distribute the supplier's goods. In return, the operator pays the supplier a fee.
- Thirty three countries, including the United States, China, and Australia, have laws that explicitly regulate franchising, with the majority of all other countries having laws which have a direct or indirect impact on franchising.
- Franchise agreements carry no guarantees or warranties, and the franchisee has little or no recourse to legal intervention in the event of a dispute.

### Terms

- *Franchisee*: A holder of a franchise; a person who is granted a franchise.
- *Franchising*: The establishment, granting, or use of a franchise.
- *Franchise*: The authorization granted by a company to sell or distribute its goods or services in a certain area.
- *Franchiser*: A franchisor, a company which or person who grants franchises.

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