

Everything You'll Need to Plan Your First Master Franchise

Setting up a master franchise is a complex business best handled by experts. Here, in detail, are the steps you'll need to take to carry this off successfully

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Planning for your first Master Franchise assumes that an analysis of the various franchising models has determined that Master Franchising is the appropriate vehicle for this particular international expansion opportunity. While the factors involved in comparing each model are beyond the scope of this article, it is extremely important that they be evaluated.

Now, what is involved in planning for that new venture?

Master Franchising grants a "Master" the right to operate directly and also to "Sub"-franchise in a defined territory. Therefore, the Master in that territory will manage many of the functions for itself and its Subs that the Franchisor handles directly in other markets. It is important to note, though, that the Franchisor is in effect delegating these responsibilities, but it is not abdicating them. The Franchisor must develop a plan and an organization that allow it to continue to maintain oversight and sometimes more direct involvement in all areas of the business during the course of the relationship.

Preparing a plan

The first step in developing that plan is to fully define responsibilities for each party. As they are defined, they should be included in an overall financial model that reflects anticipated revenues, expenses, capital needs, and profitability for the Franchisor, Master, and Sub. The

ultimate test of any such plan is the expected ROI for each of the parties.

All of the components of such a plan are inter-related, so the best plan and financial model will allow for modifications in one area to be adjusted in others. All of these will eventually be documented in a Master Franchise Agreement (MFA).

Support responsibilities

One approach would be to look first at the support requirements and the level of responsibility the Franchisor is prepared to delegate.

Operations and Training are usually the backbone of the Franchisor's brand. The Franchisor should have very strong procedural documentation in place as well as systems for teaching those processes. Operations and Training can usually be readily delegated to the Master, and the Master can use the Franchisor's core manuals, procedures and systems after adapting them as necessary. The Franchisor will have to periodically monitor Operations in the field to ensure that the Master and the Subs are complying with their responsibilities.

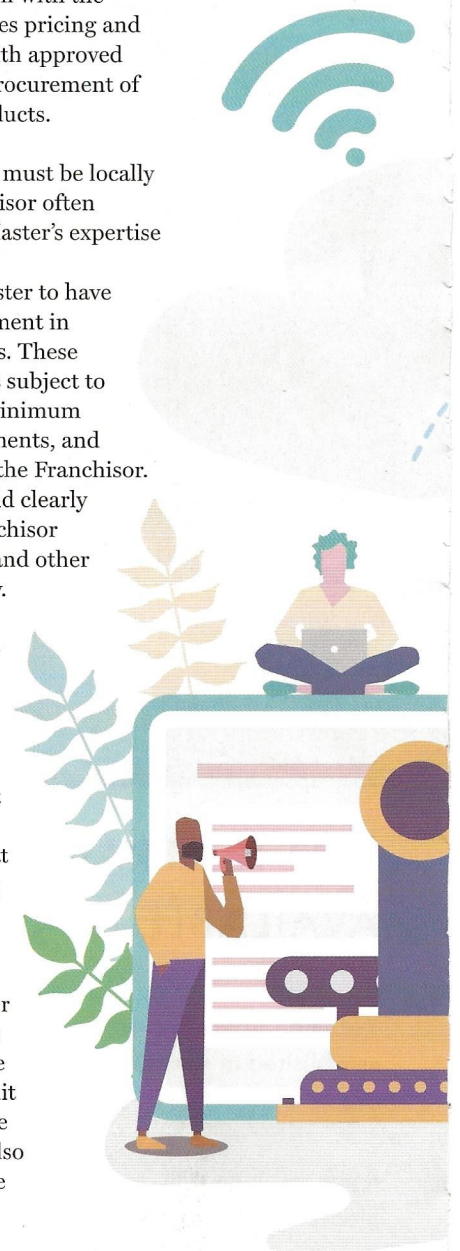
Supply Chain, particularly in restaurants, is a critical element of the Franchisor/Master relationship, and this is an area where perhaps less delegation is done by the Franchisor. In its simplest terms, the Franchisor determines what ingredients must be used and it has approval authority over the producers of those ingredients.

In markets where some items are locally produced, the Master, often in collaboration with the Franchisor, negotiates pricing and contracts directly with approved local suppliers for procurement of those approved products.

Because **Marketing** must be locally relevant, the Franchisor often acknowledges the Master's expertise in its own market and permits the Master to have more direct involvement in marketing initiatives. These are, however, always subject to Brand guidelines, minimum investment requirements, and final approval from the Franchisor. Also, the MFA should clearly define that the Franchisor owns all the marks and other intellectual property.

Development and Real Estate

are similarly more localized activities. The Master will have a Development commitment, as discussed below, that will involve opening and operating its own locations as well as those of its Subs. The Franchisor should provide tools for the Master to use in its efforts to recruit Sub-franchisees. The Franchisor should also provide the template



agreement that the Master will sign with its Subs, and many Franchisors reserve the right to approve each Sub. The Master's site selection criteria should be based on the Franchisor's Real Estate guidelines, adapted for local characteristics.

Territory and Development

The Master often hopes to get a commitment for the largest possible territory. The Franchisor, however, should avoid the temptation of a large fee and establish the territory grant in a way that clearly defines a smaller initial geography, with possible options for incremental territories at agreed intervals if the Master is in compliance with its obligations.

The Development requirement should be realistic, based on the territory's potential and on the

Master's organizational and financial capacity. It is better to start with expectations that can be achieved, rather than an unrealistically high requirement that can lead to later difficulties in the relationship.

Very importantly, the Franchisor should establish a fixed minimum number and percentage of locations that the Master must operate itself before it is permitted to recruit Subs. For example, assume that the Master must operate 10 locations itself, with a further requirement that it must always have in operation 10% or more of the total number of locations in the territory. Therefore, in this example, as long as the Master is operating 10 locations itself, it may sign up to 90 Subs before it has to open additional Master-owned locations.

The specific numbers can be adjusted based on the size of the

territory and the Franchisor's strategy, but the concept of requiring the Master to own and operate a defined number of locations is significant for several reasons. One is that these owned locations provide "proof of concept" examples for potential Subs in the local market. Another reason is that the Master can use its own locations to test products and services before rolling them out to the entire system. And finally, the Franchisor wants to ensure that the Master has a significant direct investment in the business and is not focused solely on selling Subs.

Term, Disputes and Termination

The Master would like a very long or perpetual term, while the Franchisor should plan to establish limits that will provide alternatives in the



event that circumstances change over time.

The Franchisor should also prepare for what might happen if the MFA expires and isn't renewed, or if the Franchisor determines that it should be terminated. Among the related considerations to be included in the MFA is the ability for the Franchisor to establish a direct relationship with the Subs under certain conditions.

The MFA should also specify which country's laws will apply in the event of a dispute and where disputes will be contested. International commercial arbitration in a neutral venue is often a more appropriate choice than litigation.

Revenue sharing and Fees

Unfortunately, there are no standard solutions to revenue sharing and fees in international Master Franchise Agreements. It's a combination of art and science based on industry, Franchisor and market practice, resulting in a wide variety of arrangements.

The Territory Fee is paid directly from the Master to the Franchisor to secure exclusivity for the defined territory, subject to compliance with contractual obligations. Once the development potential and



as each location is opened. That fee can be in the range of US\$5,000 to US\$60,000, depending on industry and Franchisor practice. The Franchisor generally specifies the fee, or a fee range, to be charged by the Master to a Sub, to protect against the adverse effects of a fee that is too high. For the Master opening its own locations, that fee is paid in full to the Franchisor. For Subs, the fee is paid to the Master and then the Master remits a portion to the Franchisor.

principles. There might be fees for Marketing, IT, Supply Chain or other services and the Franchisor can establish the respective amounts to be charged to the Master and the Subs. The split can vary depending on the service provided by the parties.

Revenue The final plan

Before recruiting that first Master, all of these elements will have to be planned, financially modeled, and written into a Master Franchise Agreement. Throughout that process there is no substitute for advice from experienced international Tax and Legal counsel.

This planning process is based on the idea that the Franchisor will have to "teach the Master how to be a Master". The Franchisor's plan must reflect the systems, processes and organization that will be needed to first teach those skills and then continuously monitor performance.

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schedule have been determined, the Territory Fee is usually assessed based on an amount per unit multiplied by the number of agreed units. For example, in the quick service restaurant business, those fees could be approximately US\$5,000 to US\$10,000 per location to be developed. So, for a 50 location agreement, the fee could be US\$250,000 to US\$500,000. This fee can be paid in one upfront payment or in a series of payments over time.

Then, there is an Initial Fee paid

That percentage usually ranges from 50/50 to 20/80, in favor of the Master.

There is also an ongoing Royalty fee. Royalties usually range from 1% to 7% of sales, paid to the Franchisor in full for owned locations and with a split for Subs that might range from 50/50 to 20/80, in favor of the Master. Again, the Franchisor should determine a maximum Royalty rate that the Master is allowed to charge to a Sub.

Other fees follow the same



THE AUTHOR

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