

## International Expansion – Taking Your Brand Overseas

Many franchisors from time to time contemplate taking their brand overseas. If done properly, international expansion can be very rewarding in both a personal and financial sense. If done poorly, without preparation and before your system is in position to go overseas then the experience can be quite damaging.

This article seeks to provide some handy hints to franchisors looking to take their brand overseas. The matters raised in this article are not exhaustive but do serve to highlight some of the more fundamental issues to be considered by any system looking to expand internationally.

### Structure

From time to time you will hear many terms being discussed in the context of international franchising. Whilst there is no one correct model to be followed some of the main structures that you should consider include the following:

**Master Franchisee** – typically this involves the Australian franchisor granting rights to an overseas entity to establish the system and to grant sub-franchises to third parties.

**Direct Franchising** – in this case, the Franchisor enters the foreign market itself granting franchises directly in that country. Sometimes this is done by the acquisition of a rival system in the foreign country in order to give the franchisor a starting base.

**Area Developer** – under this model a local party is given Area Developer status which entitles it to open a set number of units itself. This sort of structure relies heavily on the Area Developer having sufficient capital resources in order to be able to set up the requisite number units and to meet the minimum performance criteria set by the franchisor.

**Joint Venture** – under this model, the Franchisor either actually holds shares in the foreign developer or alternatively the parties enter into a joint venture arrangement for the 2 entities to establish and operate the system overseas. One of the benefits of holding shares in the developer is that in certain countries (in particular in the Gulf States) such ownership confers additional rights on the Australian franchisor. This may be of particular interest as in some foreign countries they do not recognise Australian companies or Australian law.

The better model to be adopted will in part depend upon the country into which you are seeking to expand, your own financial resources and in part the cultural and economic issues in that country. Experience suggests that the best developers should be established local business people who have a proven track-record in the relevant country, have established offices and IT systems and have a commitment to success and cooperating with the franchisor and the system. Ultimately the success of international expansion will depend heavily on attracting the right developer irrespective of the structure to be adopted.

### Trademarks

Even before entertaining the thought of going overseas it is important that you properly protect the Intellectual Property within your system. Most franchisors know the importance of protecting their trademark domestically but few consider this as an issue until international expansion is

upon them. If international expansion is a possibility for your system you should immediately make enquires of your advisors to protect your trademarks.

Previously it was very difficult, time consuming and expensive to seek to register trademarks in various countries. Since July 2001 Australia has been a signatory to an International Treaty known as the Madrid Protocol for International Trade Marks (the Madrid Protocol), which now enables registration of trade marks in other countries more simply and cheaply. Monitoring and maintaining your marks overseas is also simpler and less costly. So far over 60 countries are signatory to the Madrid Protocol including the UK, US, EU, Japan and China.

The Madrid Protocol enables one application to be lodged in order to register a trade mark in all or any of the countries that are currently signatories to the treaty. You will also be able to designate any countries which become members in future without filing a new application.

Many of the add on costs by agents in the various jurisdictions are now also avoided with the introduction of the Madrid Protocol as applications are filed via the Trade Marks Office in Australia, are in English and attract fees in Australian currency. An international registration will continue to exist indefinitely, subject to renewal every 10 years. Any further maintenance of the trade mark such as assignment or change of address will be streamlined through IP Australia.

In order to seek protection under the Madrid Protocol an application must be based on an Australian trade mark registration or pending application. Your class specifications must also be for the same goods and services as those detailed in the Australian trade mark application.

The other thing to bear in mind when registering trademarks internationally is to ensure that the trademark is protected in English and in the local language eg, Arabic or Chinese characters should also be the subject of a separate trademark.

## **Due Diligence/Research**

Prior to granting any rights overseas it is important to determine whether or not your system is capable of being transferred overseas and being successful. Just because a franchisor has enjoyed domestic success does not guarantee it success in a foreign market.

It is important to determine that there is a genuine demand for the product or service overseas, that culturally the system is accepted overseas, that the system can be adapted for a foreign country and the financial modelling for your system makes it viable overseas.

Financial modelling is a critical part of successful international operation. Prior to expanding your system you should carefully analyse your business model to ensure it is capable of being adapted successfully overseas. By way of example, the cost of goods sold in Australia may be significantly different overseas when one takes into account stock supply issues. Are products capable of being sourced locally at competitive rates and within the range contemplated by your Australian business model or will they need to be purchased from the Franchisor direct at significant additional cost? Additionally, the issue of wages in certain countries may make your model more or less competitive.

Further, consider issues such as the cost of store development, fixed costs such as rents and the impact of different royalty structures on the financial viability of operators.

## Operations Manuals

Prior to expanding overseas it is important that all operational procedures are comprehensively documented in operations manuals and that those manuals have been tested in the Australian market place. Inadequate manuals will reflect poorly on you as a franchisor and lead to discontent.

Your agreement with your Developer should enable the Developer to suggest changes to the manuals and to amend those manuals for cultural and local customs. You should be wary of substantive changes in this regard as it will ultimately compromise your system given a cornerstone of successful franchising is uniformity.

Also consider who will be responsible for converting the manual into a foreign language. You should maintain control of this process to ensure that the translation is truthful and does not undermine your system.

## Fee Structure

One of the most commonly asked questions is what fee should one impose as the initial fee to secure the rights for a foreign territory? One possible way is to consider the amount of units that can be established in the territory against the number of units likely to be established and use this as the starting point for determining the initial fee.

The upfront fee should be calculated so that the Developer can recover its initial fee during the term of the grant and to make a reasonable return on its investment. It is also important to establish performance criteria in consultation with the Developer so that the Developer remains focused on maximising the development of the system.

Other possible fees for Australian franchisors include initial training fee, royalties, transfer fees upon the transfer of the rights etc.

The charging of royalties overseas is sometimes a vexed question. Culturally some countries prefer a flat fee rather than a percentage royalty. The charging of percentage royalty in such countries makes it difficult to sell sub-franchises and from experience results in sub-franchisees not truthfully declaring all sales.

In addition, if you are supplying stock directly to operators overseas then the royalty to be charged is likely to be less in those circumstances.

You should also require your Developer to have an advertising fund which is to be used for the benefit of the system as a whole.

## Stock Supply

If you are considering supplying stock overseas you should also consider:

- Local labelling laws,
- Import duties,
- Term of supply,
- When does risk in the stock pass?
- Ensuring that the products can be legally imported into the country.

## Miscellaneous

Some other considerations include:

Training – will initial training occur overseas or locally? If locally, who will pay the costs of travel and accommodation?

Store construction – who will be responsible for constructing and fitting out premises? Are all materials readily available overseas or must they be prepared and shipped from Australia?

Insurance – some countries do not view insurance as importantly as Australians do and accordingly terms in an agreement concerning the taking out of insurance may be a point for disagreement.

Reporting – what sorts of reports will be required, how often and will online access be given?

Conversion of your Franchise Agreement – it is highly recommend that you seek the advice of local professionals to convert your Franchise Agreement so that it complies with local laws.

Legal issues – the litigation of disputes and the enforcement of judgments overseas continues to be a complicated affair. There is specific terminology under the regulations which should be adopted to ensure ease of enforcing obligations internationally.

## Conclusion

International expansion is a detailed process. There are different specific requirements in each country. For instance, changes recently made to Chinese law mean that effective from 1 February 2005 it is not possible to grant franchise rights in that country until the franchisor has owned and operated 2 company owned stores for a period of no less than 12 months. Similar considerations apply to some European countries.

You should carefully do your homework in anticipation of going overseas if international expansion is on your horizon. As always, you should seek appropriate professional advice to assist you in doing so. Whilst expansion within Australia can be rewarding there is no doubt that given economies of scale and the large population in certain countries, international expansion can be also extremely lucrative and personally gratifying.

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