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Want to Expand Your Brand? Consider Franchising!

By Ari N. Stern on June 17, 2024

You have one location and are killing it: your buildout and operation costs are far less than you expected, while your revenues, and relatedly, your profits, far exceed your wildest dreams. You are thrilled by your return on investment and what you have achieved. You now want to get bigger—much bigger.

But you realize that there are certain challenges ahead. In particular, you have limited capital and are concerned about your ability to raise funds from friends and family. You also are not inclined to take out one or more loans from a bank and/or another lender because of high, cumbersome interest rates.

The financial piece aside, you are also concerned about recruiting, employing, and managing a workforce in states (or possibly countries) other than the one in which you live. Relatedly, you are concerned about complying with laws that may apply to your business concept in a given state/country that are not on the books where you currently operate.

So, what do you do? How do you grow?

One path forward is to franchise, that is, to sell a "business in box" to investors who will pay you a royalty and other fees so that they may independently own, open, and operate one or more units of your business concept in a given territory (or territories). The folks who invest in your brand – known as franchisees – are generally responsible for, among other things, all of the challenges highlighted at the outset of this article: the costs and expenses associated with buildout and operation, as well as the efforts that need to be undertaken to recruit and manage a workforce.

The duties, rights, obligations, and responsibilities associated with a franchise relationship are typically set forth in a written instrument known as a franchise agreement. In certain jurisdictions, an oral franchise agreement may be found to be enforceable and will be enforced.

Whether franchising your business concept and, in turn, becoming a franchisor is advisable depends on several factors. Under the Federal Trade Commission – Franchise Rule, found at 16 C.F.R. Parts 436 and 437, respectively (the "Franchise Rule"), the term "Franchise" is defined to mean:

> "[A]ny continuing commercial relationship or arrangement, whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents, orally or in writing, that:

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> (1) The franchisee will obtain the right to operate a business that is identified or associated with the franchisor's trademark or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor's trademark;
>
> (2) The franchisor will exert or has authority to exert a significant degree of control over the franchisee's method of operation or provide significant assistance in the franchisee's method of operation; and
>
> (3) As a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate."

See 16 C.F.R. 436.1(h). Accordingly, from a general perspective, you need to have the following if you are going to franchise successfully:

- A trademark that is unencumbered and can be properly licensed to one or more investors.
- A business concept/model that is proven.
- A business concept/model that you can teach/train others to replicate.
- A system for providing franchisees with relevant training, assistance, and support both now and in the future.
- A system for monitoring and ensuring compliance with brand standards and expectations.

Unless one or more exemptions apply, information about a franchise offering in the United States is furnished to potential investors as part of a Franchise Disclosure Document or "FDD." The construction and development of this formal business prospectus is governed by the Franchise Rule and certain state laws (assuming you seek to franchise in those states). The Franchise Rule and certain state laws also set forth mandates and prohibitions associated with courting a prospective franchisee into a franchise relationship.

Notably, in certain states, a franchisor needs to file and/or register with the state before offering the franchise opportunity to others. However, most states have no filing and/or registration requirements.

You should consult with competent attorneys, accountants, and financial advisors to better understand the pros and cons associated with franchising and other methods of growing your brand. Indeed, a method of growth that may work for one brand may not work for another; an individual assessment should be performed.

On the legal front, RIW's **Franchise Law Practice** is well-equipped to provide legal perspective, counsel, and assistance to franchise-related entities, owner-operators, executives, and investors. It is comprised of seasoned professionals who offer key corporate, transactional, and dispute resolution services to franchisors, master franchisees, franchisees (multi-unit and single unit), and franchisee associations.

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