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SETTING UP A FRANCHISE

James McCubbin, a solicitor with Dundas & Wilson, examines what's involved in setting up a franchise agreement and warns of the pitfalls EXPERT ADVICE

In the UK the franchise industry is self-regulating, so there are no specific laws governing franchise agreements. The British Franchise Association has a code of ethics which outlines the best practice between those granting the right to run franchises (franchisors) and those who will be running the franchise. However, this code is not binding and the contract between the parties will normally reflect the stronger bargaining position of the franchisor. It is better if the franchisor is a member of the British Franchise Association, as its members will have agreed to abide by this code of ethics and are less likely to be involved in sharp practice.

A franchise agreement is likely to be heavily weighted in favour of the franchisor as it will want to impose strict controls over how the franchise is run, eg, how the products are displayed and marketed. If you wish to have autonomy over how a business is run then franchising is not the type of business you want to be involved with because the franchisor exerts a high degree of control over how the business operates.

The most important benefit of franchising is the support network of advice that the franchisor can give to those running the business during the initial stages of setting up a franchise, which you don't normally get when you set up a new business.

Given that the franchise will be based on a successful business model, if financial backing is required from a bank or similar lender to set up the franchise, then accounts from previous franchises of a similar size can show the likely returns that could be made. Banks will be more easily persuaded to lend money where it can be shown that similar franchises have been successful.

It is also worthwhile accessing the British Franchise Association's website, which provides further information and practical advice on setting up a franchise.

CHECK LIST

- Ask the potential franchisor whether it is a member of the British Franchise Association and ask if it incorporates any of the code of ethics into its contracts.
- The geographical boundaries of the franchise area should be clear so that no rival franchises can be set up which would compete with your business.

- You should have the necessary rights to use all of the logos and trademarks needed to run the business along with any secret "know-how".
- If financial backing is required from a bank then those running the franchise should ask the franchisor to produce illustrations of the likely financial returns that could be achieved based on past performances of similar franchises.

BEWARE

Those who view running a franchise as a stepping stone to gain experience of a particular line of business and wish to set up a similar business when the franchise ends should make sure that the franchise agreement does not contain any restrictions preventing this.

These provisions are known as "restrictive covenants", and can stop you setting up a similar business within the same locality as the original franchise for up to two years after the franchise ends.

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By James McCubbin

THE PROBLEM

You wish to set up in business and feel you have the necessary management skills to make it a success, but do not have any expertise in a particular type of business or any previous experience of managing a commercial enterprise. Franchising permits those running the franchise to use an established name to market and sell products or services, which can be the ideal opportunity for individuals with limited business experience as they will be following a proven formula which has been financially successful in the past. A prime example of franchising is McDonald's, which has used this arrangement to successfully expand its business on a global scale.

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