Reducing Your Risk When Growing Your System Abroad

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The Legal Intelligencer
By Craig R. Tractenberg

Growth can be expensive, but it is always more expensive when the expansion is taken without risk assessment. Whether domestic or foreign, many risks can be reduced or avoided by proper consideration of differences between where you are now and where you want to go. For illustration, the examples will be for foreign expansion, but the same issues confront domestic expansion as well.

Factors to Be Taken Into Account in New Territories

National chains offer localized products in particular territories. A hamburger franchisor offers biscuits in the South, and lobster rolls in the Northeast, and chili peppers on everything in New Mexico, even with all of its hamburger options. What are the consumer preferences in the new frontier?

Now imagine going global. In India, the hamburger giants need to rename their signature sandwiches because cows are sacred. In addition, the packaging must reflect at a distance whether the contents are vegetarian. Church's Chicken is understandably called Texas Chicken in the Middle East to avoid offending the majority populations.

Logistics must ensure that the quality and availability of the products is reliable and the look and feel of the retail outlet reflects the brand. You will need to ensure the availability of products, fixtures, supplies and equipment. The goal is instant recognition of the brand. Freshness and quality is essential. You do not need headline risk if your food is not wholesome.

In comparing risks to rewards, your ultimate goal is to generate more revenue and promote awareness of the brand. But what sort of investment do you need to incur before those goals are realized. Growth is never cheap and cheap growth is never good. You need to know the growth is suitable and sustainable. Let’s take a look at some of the legal and business issues.

Diligence on Legal Matters

Are there operating hour ordinances that might affect the business? How about limitations on operating hours or days by the landlord? For foreign expansion, the inquiry is whether it is even legal to sell the goods and services in the foreign market. In the Middle East, not every country allows pork or alcohol products to be sold.

Trade names and trademark protection is essential, but do you know if there are similar names or businesses already in the market that will confuse your customers? Do prior users exist which could create a threat to your brand? In foreign countries, you need to know whether the name is available for protection and whether it must be registered before selling a franchise.

Does the new territory have different rules on regulation or disclosure? Are there local laws which require disclosures, require registrations, require preapproval of advertising, or permit rescission in the absence of compliance? U.S. franchisors probably know the national rules, can acquaint themselves easily with local counsel to learn the rules, but going cross-border requires local knowledge. One needs to know whether the local country franchise laws require or exempt registration, or approval prior to offering a franchise. Jurisdictions which have special franchise laws often will require mandatory disclosures, or a “quiet period” between offer and acceptance.

The local rules on termination and renewal need to be explored. Some jurisdictions require franchises to be “evergreen” such that they never expire under the law until the franchisee commit a material breach. Some jurisdictions allow termination but require buy backs from the franchisee of inventory, or some type of compensation. Some jurisdictions allow enforcement of restrictive covenants and others invalidate the restrictions as anticompetitive. In some foreign countries, preregistration of intellectual property is required, and the property reverts to the franchisee after a period of operation. Mitigation of these risks need to be baked into the deal from the outset.

Reputational Due Diligence

A frequently overlooked aspect to development is whether the addition of this geography and operator improve the reputation of the brand. One might first start by measuring a baseline of the reputation of the brand. Then examining the reputation of the folks who are intended to help you expand the brand. News sources, media and social media sites associated with the shareholders, principals and officers should be reviewed. References should be requested and should be checked. In foreign countries, that might require the use of a translator and/or investigator.

Financial Due Diligence

In the United States, we can rely on credit reports, criminal records searches and electronic searches. Cross-border data and privacy laws create barriers to common search methods used in the United States. The foreign search tasks will take longer and will require more cooperation from the prospect. Foreign data is difficult to assemble, and may not be as robust as is available.

In conclusion, expansion always requires acceptance of risk, with its many considerations such as taxes, dispute resolution, the cost of compliance and serious consideration of governing law. Expert advice should also be sought when traveling into the unknown.