

Franchising Terminology

Every industry has its “language” – here are some terms with which you will want to become familiar.

Area development agreement

FDD
FDD

royalties

CSR

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BizOpp

Operations
Manual

Trademarks

Executive Summary

Every industry has its language – and so does franchising! You may want to keep this guide handy until you become more familiar with various terms.

The first ten below are the most commonly used terms or phrases you will find in franchising.

Capital Required: The amount of money a Franchisee will need to ramp up their franchise business during the start-up phase (average 3 to 15 months) to the point of producing a profit.

Exclusive Territory: This is the region or area a Franchisee will have exclusive rights to operate within. It is generally defined and mapped in terms of targeted households or population.

FDD: An acronym for “Franchise Disclosure Document” -- an extensive legal document that provides you with “all you need to know” about a particular franchise. Regulated by the FTC, the FDD contents must be disclosed to potential buyers before purchase.

Franchise: *The legal rights* (the surrounding trademarks, copyrights, franchise operating system, support, training, product or service) *a Franchisee obtains* from a Franchisor under a franchise agreement *to operate* within a designated contract period *as their business*.

Franchisee: The *person, partnership or company* who pays the Franchisor for the right to own and operate a business using the Franchisor’s marks and system.

Franchisor: The person, partnership or company that *controls the overall rights* to the franchise.

Franchise Agreement: *A non-negotiable contract, per FTC regulations*, between a Franchisor and a Franchisee in which the Franchisor grants the Franchisee certain legal rights to use the Franchisor’s marks and system in connection with a business to be independently owned and operated by the Franchisee.

Liquidity: The total cash available to a franchise owner for business operation or living expenses.

Net Worth: Your assets (i.e., the cash value of all you own) minus your liabilities (i.e., what you owe).

Royalty Fee: An ongoing fee paid to your Franchisor for support services received through the life of your contract – usually a percentage of gross income or a flat monthly fee.

If there are any terms you do not see, ask your consultant.

A

Acknowledgement Of Receipt: This is a page signed by prospective franchisees upon receipt of the FDD, and then returned to the franchisor, as proof that the franchisor delivered the FDD on a particular date.

Advertising Fee: A franchise agreement may request a contribution by each franchisee to an “advertising fund.” This is a periodic fee to fund specific advertising and marketing program development for the franchised business, such as artwork for ads or coupons, radio spots, etc. It does not replace local marketing efforts by the franchisee. It may be based on a percentage of the franchisees’ revenues (typically less than 3%) or a flat fee. It may be due weekly, monthly, quarterly or annually.

Affiliate: A business entity that is controlled by the franchisor, or that controls the franchisor, or that is under common control with the franchisor.

Approved Supplier: A supplier of products and services is approved by the franchisor to provide products or services to its franchisees. A franchisor may designate itself or its affiliates as approved suppliers. Franchisee may sometimes be required to purchase certain products or services only from approved suppliers.

Arbitration: Arbitration is a form of dispute resolution in the event of a disagreement between the Franchisee and the Franchisor, and is normally chaired by a nominated individual or independent third-party. The Franchise Agreement may or may not provide for arbitration between the parties to the Agreement.

Area Development Agreement: A term that refers to the specific agreement provided for multiple unit or territory purchases of a particular franchise. Generally, an ADA will allow a prospective Franchisee to purchase several units – but not have to open all of the units or territories at once. With a cash deposit, the Franchisee can “hold” the units, and then open them at a designated time in the Area Development Agreement – usually 12-15 months after the opening of the prior unit.

Assignment: The sale of a franchise by one Franchisee (assignor) to another (assignee) is called an “assignment.” In most FDD’s, the Franchisor designates an “assignment fee” that must be paid by the original franchisee – which is then used by the Franchisor to train and induct the new Franchisee.

B

B-2-B: An acronym for “Business to Business.” Used to describe a type of franchise whereby a Franchisee offers products or services of use to other businesses, not to consumers.

B-2-C: An acronym for “Business to Consumers.” Used to describe a type of franchise whereby a Franchisee offers products or services of use to consumers (**B-2-C**).

Business Opportunity: A term used to describe a non-regulated business offering. Buyers should be beware that these offerings are not protected by FDD compliance laws. (Also known as “Biz Opp.”)

C

Capital Required: The amount of money a Franchisee will need to ramp up their franchise business during the start-up phase (average 3 to 15 months) to the point of producing a profit.

Company-Owned Units: Units (or territories) of a franchise that are owned by the Franchisor. Such units allow the Franchisor the ability to test new ideas and products without detriment to the overall operation of a particular franchise. Usually these units are required to contribute to an advertising fee or any such group expenses.

Consumer-Driven: a term that is often applied to franchises that appeal only to consumers rather than businesses. Same as B2C, or “Business to Consumer.”

Conversion Franchise: When a franchisor purchases a business or existing franchise with the intention of converting that business to a “newly-fitted” franchise business. Some printing franchisors, for example, use this model to convert older, offset printing businesses to new, digital printing franchises.

D

Default: The failure of the franchisor or franchisee to perform according to its obligations under the Franchise Agreement. Either party is said to be “in default” with regard to their agreement.

Disclosure Document: See “FDD.”

Disclosure Laws: State and federal laws that require franchisors to provide certain information to prospective franchisees before they sell them a franchise.

Disenfranchise: The withdrawal of the franchise by the Franchisor from the Franchisee. This is likely to occur when there have been persistent breaches of the Franchise Agreement by the Franchisee that have been brought to the Franchisee’s attention, and have not been resolved.

Dispute Resolution: A mechanism provided in a Franchise Agreement for Franchisors and Franchisees to deal with disagreements, should they occur. Not quite the same as arbitration – usually precedes arbitration and is designed to resolve issues before they require legal intervention.

E

Earnings Claim: Any information that a franchisor provides to a prospective franchisee from *which a specific level, or range, of actual or potential sales, costs, income or profit can be easily ascertained* relating to franchised units or company-owned units.

Exclusive Territory: This is the region or area a Franchisee will have exclusive rights to operate within. It is generally defined and mapped in terms of targeted households or population. (Note: Not every franchise offers this right, but many do.)

Expiration: Used to describe natural end of a franchise agreement term – generally 10 years.

F

FDD: An acronym for “Franchise Disclosure Document” -- an extensive legal document that provides you with “all you need to know” about a particular franchise. Regulated by the FTC, the FDD contents must be disclosed to potential buyers before purchase.

Federal Trade Commission (FTC): The Federal agency in Washington, D.C. that regulates franchises.

Franchise: *The legal rights* (the surrounding marks, system, support, training, product or service) *a Franchisee obtains* from a Franchisor under a franchise agreement *to operate* within a designated contract period *as their business*.

Franchisee Advisory Council: The Franchise Agreement may provide for the formation of a Franchise Advisory Council -- with Franchisees assuming the role of assisting the Franchisor with certain group decisions.

Franchise Agreement: A contract between a franchisor and a franchisee in which the franchisor grants the franchisee certain rights to use the franchisor's marks and system in connection with a business to be independently owned and operated by the franchisee.

Franchisee: The person, partnership or company who pays the Franchisor for the right to own and operate a business using the Franchisor's marks and system.

Franchise Fee: Often referred to as "initial franchise fee." This is a one-time, up-front payment by the Franchisee to the Franchisor for the rights to a franchise. This fee is due and paid once the Franchise Agreement is signed, is generally non-refundable, and precedes final payments.

Franchisor: The creator of a franchise system. The party to a franchise agreement who grants prospective Franchisees the right to use the Franchisor's marks and system.

G

Goodwill: A term used to describe the value of trade already established in a particular business that is likely to continue to the benefit of the new business owner.

Multi-Unit Franchise: A Franchisee that owns more than one unit. Multi-unit owners are often the strongest operators in a franchise system – plus, a system with many multi-unit operators is one that is likely performing quite well.

Multiple Franchisors: Franchisors offering more than one franchise concept.

H-I

Intellectual Property Rights: Trademarks, service marks, know-how and copyright. These often form an important component of the franchise system.

Initial Investment: The minimum amount of money generally required to begin operating a franchise. This amount typically includes the initial franchise fee, any required purchases from the franchisor, and all other common costs and expenses involved in starting up a franchised unit. Most Franchise Agreements provide an estimated range of investment costs, taking geographic variances into account.

Initial Training: The formal instruction the Franchisor provides its Franchisees in terms of operating the system. Generally includes (at minimum) a comprehensive review of operations manual, training on scheduling and/or financial software, marketing and advertising, and legal requirements.

J-K-L

Lease: A rental contract for a retail space.

Licensee: See Franchisee or Master Licensee.

Liquidity: The total cash available to a franchise owner for business operation or living expenses.

M

Marketing Fee: See "Advertising Fee."

Marketing Manual: A manual of information intended to guide a new franchise owner in how to promote and effectively market their products or services into the community. Such manuals will provide bromides of forms and posters to be used, together with details of how to monitor performance of the promotions conducted.

Marks: The trademarks, services marks, logo, trade dress, and other commercial symbols the franchisor grants the franchisee the right to use in the operation of their franchise.

Master Licensee: The person to whom the franchisor grants exclusive rights to offer and sell franchises within a particular territory using the franchisor's marks and system. Sometimes called a "master, or sub-franchisor."

N

NASAA: The North American Securities Administrators Association, which prepares the FDD Guidelines to facilitate compliance with state franchise registration and disclosure laws.

Net Worth: Your assets (i.e., the cash value of all you own) minus your liabilities (i.e., what you owe). Most franchise companies have minimum net worth requirements to prohibit buyers from overextending.

O

Offer: A verbal or written proposal to sell a franchise to a prospective Franchisee upon understood general terms and conditions.

Offering Circular: Used to refer to UFOC, previous description for document now called "FDD."

Opening: The time when a franchised unit first opens for business.

Operations Manual: The “handbook” a Franchisor provides to its Franchisees in printed or electronic form about the in-depth operations of the franchised business.

Owners: The individual owner(s) of a franchise that is a legal entity such as a corporation, general partnership, limited partnership, or limited liability company.

P

Predecessor: Any person from whom the *Franchisor* obtained most of its assets.

Public Figure. Any celebrity or well-known figure who endorses a franchise or whose name or image appears in the franchise name or symbol.

Q-R

Registration: The process of officially filing with state franchise regulators certain specific information and forms required by state law. In many states with franchise registration laws, registration is not effective until the franchisor’s application is approved by the state franchise regulators.

Registration Laws: State laws that require franchisors to register the franchise with the state before making any offer or sale of a franchise in the state.

Relationship Laws: State laws that govern the relationship between franchisors and franchisees, such as laws that limit the grounds for which a franchise can be terminated.

Renewal: The extension of the term of an expiring franchise, or the granting of a new franchise upon the expiration of the old one.

Royalty Fee: An ongoing fee paid to your franchisor for support services received through the life of your contract – usually a percentage of gross income or a flat monthly fee.

S

Service Mark: A distinctive name or symbol used to identify the franchisor’s services and to distinguish them from the services of others.

T

Term: The time period during which the franchise agreement will be in effect.

Termination: The premature ending of the term of a franchise agreement by one of the parties to the agreement.

Trademark: A distinctive name or symbol used to identify the franchisor’s products and to distinguish them from the products of others.

Transfer: The sale or other transfer of the ownership of the franchise agreement, the franchised unit, or assets of the franchised unit from the franchisee to another person.

U - Z

UFOC: An acronym for “Uniform Franchise Offering Circular” – the document now known as the “FDD.”

