

Franchise Terminology

To be able to conduct an intelligent evaluation of any franchise – you need to “know the lingo.” Every industry has its terminology, and franchising is certainly no different.

So we’re going to start you out “easy.” Here are the *10 most important terms* you will need to know before you buy. Then – read on!

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.

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.

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: Typically a percentage of gross sales paid by the franchisee to the franchisor on a regular basis. May also be a fixed or other fee basis.

FDD: An acronym for “Federal Disclosure Document” -- an extensive legal document that provides you with “all you need to know” about a particular franchise business, the franchisor and the franchise agreement. Regulated by the FTC, the FDD contents must be disclosed to potential buyers before purchase. (Used to be called the UFOC)

If you have questions about any of these terms, make a note, and remember to ask me to explain it to you.

A

Acknowledgement of Receipt: Item 23 of the Franchise Disclosure Document (FDD) that is signed by the prospective franchisee and provided to the franchisor (in hard copy or electronically signed) as proof of the date the FDD was received by the prospect.

Advertising Fee: An amount paid by the franchisee to the franchisor as a contribution to the franchise system’s advertising fund(s). The fund is typically established to pay for the creation and placement of advertising, and is used to offset the franchisor’s administrative costs relating to “retail/brand” advertising. Payments are typically calculated as a percentage of gross sales.

Agent: A party that has implied or express (oral or written) authority to act on the behalf of another.

Approved Advertising Materials: Materials provided by the franchisor for the franchisee’s use in their local market, or materials created by the franchisee which the franchisor has approved for use.

Approved Products: Specified products which a franchisee must buy for use in their business. Franchisor may also specify an authorized supplier (see authorized supplier definition below). Generally established to control the quality of the products used or sold by the franchisee in conducting their business.

Approved Site: A location that the franchisor determines will satisfactorily meet its criteria. Site approval by franchisor is generally not an indication of the sales potential or success of the location.

Arbitration: A method of resolving disputes.

Area Franchise: A franchise relationship that allows the franchisee to open multiple locations, usually in a defined territory within a pre-agreed upon timeline. Area franchisees usually pay an area fee for the rights granted by the franchisor.

Authorized/Designated Supplier: A supplier of products and/or services used in the operation of the franchise that has been approved by the franchisor to sell to franchisees. May be the franchisor or an affiliate company.

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 UFOC’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

Broker: An outside salesperson or firm that undertakes, for a fee or commission, the sale of franchises for a franchisor. Franchise brokers are disclosed within the offering circular. Some brokers like to call themselves franchise consultants, but this is a misnomer (see franchise consultant definition below).

Business Format Franchising (BFF): A franchise occurs when a business (the franchisor) licenses its trade name (the brand) and its operating methods (its system of doing business) to a person or group (the franchisee) that agrees to operate according to the terms of a contract (the franchise agreement). The franchisor provides the franchisee with support and, in some cases, exercises some control over the way the franchisee operates under the brand. In exchange, the franchisee usually pays the franchisor an initial fee (called a franchise fee) and a continuing fee (known as a royalty) for the use of the trade name and operating methods. BFF describes the system of delivery, not the specific product or service associated with the delivery as in Product or Trademark Franchising.

Business Plan: A planning document that details the objectives for the business and establishes processes and measures for meeting those objectives.

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.

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.

C

Certification: Program by which franchisor or its franchisee may test and attest to the ability of an employee to perform certain job functions within the franchisee’s business to the franchisor’s standards. Certification can generally be revoked if the employee fails to maintain standards in performing the job function.

Company-Owned Location: A location, owned and operated by the franchisor, usually identical in appearance and operations to those of the system’s franchises. While not required, most company-owned locations contribute to the system’s advertising fund(s).

Copyright: The right to use and license others to use intellectual property, such as system manuals or other published materials.

Continuous Training: Training provided by franchisors to its franchisees, unit management, and staff, subsequent to the initial training provided.

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 Franchising: The conversion of an existing business within the franchisor’s industry into the franchise system. Sometimes includes experienced operators without operating locations.

Culture of Compliance: Company culture whereby franchisees and staff do what is right for the system based on a feeling or knowledge that it is the right

thing to do within the company philosophy, rather than because it is in the agreement or someone is watching.

D

Days: Unless otherwise stated, days generally refer to calendar days.

Day-to-Day Management: As an independent owner, the franchisee is obligated to manage the day-to-day affairs of their business to meet the franchisor's brand standards.

Default: The failure of either party to meet the terms of the agreement. In franchising certain defaults are enumerated and some can be cured in a defined period, while others may not be curable.

Design: The trade dress used by the franchise system for the franchise locations, including logo, layout, color scheme, signage, etc.

Disclosure Document: Also known as the Franchise Disclosure Document (FDD). Formerly known as the Uniform Franchise Offering Circular (UFOC). The format of the FDD is specified by the FTC and NASAA (Federal and State regulators) and provides information about the franchisor, the obligations of the franchisor and the franchisee, fees, start-up costs, and other required information about the franchise system. It includes a listing of current and former franchisees. In addition to the disclosure portion of the FDD, the document will contain the franchise and other agreements and exhibits. It does not typically include unit earnings information.

Distributorship: The right granted by a manufacturer or wholesaler to sell their products.

E

Exclusive (protected) Territory: A geographic area which provides the franchisee with certain rights, which may include exclusive operation. Franchisors may include carve-out provisions within an exclusive territory which define an excluded type of location (malls, airports, stadiums, arenas, supermarkets, hospitals, etc.).

F

Feasibility Study: An examination of the potential of a company to franchise, or of the potential success of a unit within a specific market or specific location.

Field Representative: Typically an employee of the franchisor responsible for ensuring compliance by the franchisee with system standards. Also responsible for providing assistance to franchisees in the operation of their businesses. May be a commissioned Area Representative.

Financial Performance Representation (FPR): Formerly known as an Earnings Claim, an FPR is the Item 19 representation of unit performance by a franchisor.

Footprint: Layout of a location including placement of all furniture, fixtures, and equipment.

Franchise: A relationship, as defined by the FTC and various states, which typically includes three basic elements: (1) the granting of the right to use the systems mark, (2) substantial assistance or control provided by the franchisor to the franchisee, (3) the payment of a fee (in excess of \$500) during a period of time six months before or six months following the commencement of the relationship.

Franchise Attorney: A lawyer specializing in, or with significant knowledge of, the laws, regulations and customs governing franchising.

Franchise Consultant: A business specialist with significant knowledge of the design, development, and operation of franchising and the underlying franchise relationship. Not to be confused with a Broker, who is a sales agent for the franchisor (see broker definition above).

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.

Franchisee in Good Standing: Franchisee operating their location and business in material compliance with franchisor's operating standards and is current with all payments owed to franchisor and key suppliers.

Franchising: An indirect method of distribution; in other words, a method of growth.

Franchisor: A person or company which grants the license to a third party for the conducting of a business under their marks.

FDD: An acronym for "Federal Disclosure Document" -- an extensive legal document that provides you with "all you need to know" about a

particular franchise business, the franchisor and the franchise agreement. Regulated by the FTC, the FDD contents must be disclosed to potential buyers before purchase. (Used to be called the UFOC)

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.

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.

Gray Marketing: When a Franchisee purchases under franchisor's negotiated agreements and uses the product or merchandise in another business, or sells products or merchandise to another company.

Gross Sales: When used in franchising, generally the total sales of the business before the collection of any sales taxes and after specified deductions. Generally used as the basis for percentage royalty calculations.

I

Initial Investment: The total estimated cost for establishing the business, including the franchise fee, initial fixed assets and leasehold improvements, inventory, deposits, other fees and costs, and the working capital required during the initial start-up period (three months).

International Franchise Association (IFA): The industry trade association representing franchising. The IFA is based in Washington, D.C. www.franchise.org.

Internet Sales: Any sale initiated and completed on the world wide web.

Inquiry: Anyone requesting information about the franchise opportunity, whether via the web, by telephone, by fax, or by other methods.

K

Key Supplier or Vendor: Supplier with whom franchisor has negotiated pricing or product availability and whose products or services are an integral part of the franchise system.

L

Location: The site of the franchised or company-owned operation.

M

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.

Manuals: The reference literature published by the franchisor which specifies the method of operating the business under the mark. The operations manual(s) enables the franchisor to alter and evolve the business.

Market Introduction Program: Marketing, advertising, and public relations activities used to launch the franchisee's location.

Master Franchisee: A franchise relationship which is granted for the development of a specified area, and which allows the master franchisee to sub-

franchise to other franchisees within the specified territory.

Multi-Unit Developer: A franchisee who agrees to open two or more locations, generally in a defined market over an agreed upon period of time.

N

NASAA: The North American Securities Administrators Association, which prepares the UFOC 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.

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

Operating Principal: A single individual authorized by a franchise owner to make decisions on behalf of the franchisee. This person is the operating principal and is usually the person with whom the franchisor consults in regarding the operation and conduct of the franchise.

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

Product and Trade name Franchising: The licensing of a franchisee/dealer to sell or distribute a specific product using the franchisor’s trademark, trade name, and logo (automobile or truck dealerships, farm equipment, mobile homes, gasoline

service stations, automobile accessories, soda, beer, bottling). Describes the specific product or service associated with the delivery, not the system of delivery as with Business Format Franchising.

Protected or Exclusive Territory: Protection or exclusivity granted to a franchisee by the franchisor against the opening of company, franchisee, or other locations within the territory assigned to the franchisee.

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

Quality Standards: The standards specified by the franchisor for the operation of the business. Quality standards are specified in the operations manuals, and quality franchise systems tightly control their standards for the benefit of the franchise system and its franchisees.

R

Registration: A requirement to submit the franchisor’s disclosure document prior to the approval to offer franchises within some states. There is no requirement to register a franchise at the Federal level. Registration is not an indication of state sanction of the value of the franchise offering.

Registration States: The various states that require franchisors to submit their FDD for approval prior to offering franchises. The registration states are members of NASAA.

Retro franchising or Refranchising: When existing locations that may or may not have ever been franchised, and which are currently operated by the franchisor, are offered for sale to prospects. Not the same as churning – the franchisor has an expectation that the retro franchised business will be successful (see churning definition above).

Royalty Fee: Typically a percentage of gross sales paid by the franchisee to the franchisor on a regular basis. May also be a fixed or other fee basis.

S

Service Mark: A mark used to identify the services of one company as distinguished from the services of another. Service Marks are afforded similar protection to registered marks under the law.

Single-Unit Franchisee: Franchisee who owns and operates a single location.

Start-Up Costs (Initial Investment): The initial investment that the franchisee will make in becoming a franchisee. It is also known as an Item 7 disclosure. Generally includes the franchise fee, the cost of fixed assets, leasehold improvements, inventory, deposits, other fees and costs, and working capital required during the start-up period.

Success: As used in franchising, the absence of failure or closing of a location. It does not relate to unit sales or profitability.

Successor Agreement: Franchisee's ability to continue in the business for additional terms following a successful completion of their initial term.

System Brand Fund: A fund established and managed by franchisor to which all franchised and usually all company-owned units contribute monies to be spent on promoting and protecting the franchisor's brand. Frequently called an advertising fund.

T

Trademark: The mark, name, and logo which identifies the franchisor and which is licensed by the franchisor for use by the franchisee.

Turnkey: A term used to describe a location which is provided to a franchisee fully equipped and ready to operate.