

**E**

**WIPO-KEPSA/IP/NBO/06/3**

**ORIGINAL:** English

**DATE:** February 17, 2006



THE KENYA PRIVATE SECTOR ALLIANCE



WORLD INTELLECTUAL  
PROPERTY ORGANIZATION

**WIPO – KEPSA SEMINAR ON  
INTELLECTUAL PROPERTY AND FRANCHISING FOR  
SMALL AND MEDIUM SIZED ENTERPRISES**

organized by  
the World Intellectual Property Organization (WIPO)

in cooperation with  
The Kenya Private Sector Alliance (KEPSA)

**Nairobi, January 18 and 19, 2006**

THE ROLE OF INTELLECTUAL PROPERTY IN FRANCHISING ARRANGEMENTS

*Prepared by Professor James Otieno-Odek, Managing Director,  
Kenya Industrial Property Institute (KIPI), Nairobi*

## THE ROLE OF INTELLECTUAL PROPERTY IN FRANCHISING ARRANGEMENTS

Franchising is a sophisticated form of licensing in which the franchisor licenses its Intellectual Property e.g. its trademarks, trade dress, copyright, know-how, trade secrets, business concept, methodologies and if relevant designs and patents to the franchisee.

It is one of the most effective means of exploiting Intellectual Property (IP). As in any exploitation of IP, an infrastructure that enables successful protection and enforcement of IP is crucial.

Kenya has a strong and functional IP regime and is therefore ideal for franchises to thrive. However, the franchising concept involves more than just protection of IP rights. There are other important issues that must be considered, in particular, an appropriate environment that nurtures the franchise industry and the relationship between franchisor, franchisee and third parties.

Franchising when properly structured and well run, provides benefits and satisfaction to both parties. It is however not an easy route to riches for franchisor or franchisee, nor is it a panacea for the ills of a 'sick' business.

The establishing of a franchise has to be undertaken with skill, patience and capital. The time scale for establishing a franchise system and preparing it for marketing can be as long as three years, and it can take another three to five years before the franchisor begins to see net profits and cash flow.

There are two main types of franchising:-

- Product and trade mark (or trade name), in which the franchisee uses the franchisor's trade name or trademark and sells the franchisor's products. This type of franchising is prevalent amongst motor vehicle dealers, soft drink bottlers and fuel service stations.
- Business format franchising, in which the franchisee uses the franchisor's entire business concept, which obviously includes the name and trade marks, goodwill, know-how, trade secrets, trade dress and the like. This is common in fast food franchises e.g. Steers, Nando's, Pizza-inn etc.

### What you should know

At one time or another in our lives, we all want to own our own business. For many of us, taking that giant leap towards total independence is very frightening. However, buying a franchise is a very lucrative option where you, as the franchisee, are provided with the established name of a company, including its well-known trademark and backing in form of advertising, uniforms, the location and equipment among others.

### Why Acquire a Franchise Instead of Starting One's Own Business

A franchise enables one to acquire a tried and tested business with an established reputation and a known market. The franchisor will always remain interested in the franchisee's business operation because he/she has vested interests. This means that you will also get the support and know-how from someone who has done it all before. Fellow franchisees can also offer one another a lot of assistance and support, which gives one many advantages over going it alone. Financially, one is given a very good idea of what the capital outlay will be, as well as what one's monthly expenditure will amount to. A private business often has hidden expenses that are not always anticipated.

### Key IP Issues for Both the Franchisee and the Franchisor

#### **IP and the Franchisee (the buyer of IP in the business)**

When a successful business wants to expand its operation without borrowing capital to develop, one possible option is to license its IP to franchisees. In addition to the actual product or service of the franchisor, franchise IP generally includes trademarks, logos and promotional material, business system, marketing system, various confidential know-how processes and shop fit-outs.

Franchisees usually benefit from coordinated marketing efforts managed by the franchisor. In other words, franchising is really a method of systematically sharing the franchisor's IP to distribute goods or services. The franchisor owns the IP rights over the various elements of the franchise and the franchisee pays a fee or regular royalties to use the franchisor's IP.

A major benefit of the franchise system is that you as the franchisee are able to trade under a well-known trademark. In fact, one or more trademarks will usually be at the core of most franchises. The franchisee typically is granted a trademark license, where the fee is a percentage of the gross turnover. Usually there is also a fee for a marketing budget to promote the trademark as part of the franchise business. As a condition for use and benefit from the franchisor's IP, there is a requirement imposed on the franchisee to act in accordance with a set of rules meant to preserve the value of the IP and to deliver the expected business results. This also has a potentially negative side, as the franchisor could set quite strict rules under which you trade and use the franchised IP, thereby stifling any of your own business creativity. Importantly, all your rights relative to the franchisor should be outlined in the disclosure documents presented to you by the franchisor. You can then assess whether the rules are ones you can live by. These rules should comply with the established national regulation for franchising (Franchising Code of Conduct)

A significant point to remember is that you should check the Intellectual Property clause of the franchising agreement and/or disclosure document thoroughly before you sign anything. Your legal or business advisor should look at the agreement to ensure you understand your broader obligations and those relating directly to the IP you are licensing from the franchisor.

### **IP Rights and the Franchisor (the owner of IP in the business)**

For franchisors, there are specific IP issues that come into play when considering turning your business into a franchise system. Your most powerful tools in operating a successful franchise are your trademarks and your unique business operation. It is strongly advised that you protect trademarks and unique business methods as forms of registered IP. This is not only effective business insurance for you as a franchisor, but will also provide potential franchisees with confidence that the IP they are licensing from you is secure and can be used to restrict competitor's entry into the market.

You may also wish to explore the option of exporting your franchise system overseas. In this case the protection of your trademarks overseas will be critical to your success. You are therefore advised to investigate the costs and processes involved in overseas registration.

Some other options available to you as the franchisor include the use of confidentiality agreement and the use of unregistrable IP rights such as copyright in various documentations like manual, store design and set-up. A registrable IP right will not always protect the business know-how connected to your franchise license. While many of the processes and operations of a franchise may end up in public domain (e.g. everyone will be able to see the fit-out) there could be some confidentiality obligation placed on franchisees, particularly where there is valuable operational know-how or confidential information such as secret recipes.

When you enter into a franchising agreement, generally the franchisee secures the rights to operate the business or use the IP for a set period. You as the franchisor in turn, train and support the franchisee as well as market the business. Usually there is an ongoing levy or fee and an advertising fee for this activity.

### Points to Consider Prior to Franchising

Before even contemplating buying a franchise, consider the following:

- Does the company have a well-established trademark that the general public clearly identifies with? For instance, will you be selling Coke or Coak? It sounds the same, may even taste the same, but legally it is not. You must be very careful of this, for not only will the public not believe in your product, it is also an infringement of trade mark law.
- Do the franchisors (people selling the franchise to you) have a proven track record? Ask a professional accountant to verify the correct position of their accounts books to avoid being robbed of your earnings.

- Make sure that you will receive the service and backing that they promise. Contact others who have bought the same franchise as you intend to, and ask them questions pertaining to how well the business is going. Find out if they are making profit and receiving backing and service they were promised.
- Carefully review the franchise agreement. It is advisable that you consult an attorney who deals with franchise contracts. Make sure royalties you will have to pay to the franchisor are realistic.

It is important to note that franchising your business can be a very successful way of expanding. Some of today's largest businesses have used franchising to finance and accelerate their growth into world brands. However, it must be planned properly.

- It must be pilot tested with company-owned and operated outlets.
- Business must be successful, distinctive and replicable.
- Take proper professional advice, Attorney, Banker, Accountant and possibly a Franchise Consultant.
- An experienced franchise attorney should write the franchise agreement.
- Take time to write an operations manual.
- Choose franchisees slowly and very carefully.
- Avoid overselling and forecasts.
- Have proper & quality training.
- Maintain good ongoing relationships.
- Focus on franchisee satisfaction and profitability.
- Keep developing the franchise and maintain standards.
- Ensure marketing, advertising and public relations are first class.

Remember that while you are trading on the name of the franchise, the franchisor is licensing his/her name to you in good faith. You have to work together as a team and your working arrangement must be a win-win situation, which can only be achieved in the franchisor/franchisee relationship provided the following exist:

1. Total acceptance of a common vision, mission and value by the franchisor, the franchisee and their respective staff.
2. Mutual trust and respect.

3. Clearly defined rights and obligations.
4. Good communication at all levels.
5. Dedication to long-term success.
6. Support in both good and bad times.
7. Maintenance of clearly defined operating procedures and standards.
8. Contribution to growth through feedback, research and development and ongoing promotion.
9. Timely and correct payment of fees and royalties by the franchisee.

### Advantages of a Franchise System

For a Franchisee, the advantages may be substantial.

- The franchisee may acquire an entire business system including designs, decor, stocks, recipes, management and other procedures. The precise package will vary from one franchise operation to another, the more developed operations usually preferring franchisees with no previous experience so that they may be trained from scratch.
- The franchisee is incorporated into a large business system with all the benefits of the reputation, development and other business advantages the franchisor enjoys.
- The franchisee outlet is an independent business unit and can therefore take advantage of the benefits of a small business such as better customer service, quicker response to customers, greater flexibility and better responses to change, ability to maximise local opportunities and increased morale.
- For a Franchisor, the advantages may be summarised as follows:
  - The growth of the network is achieved using the financial and manpower resources of the franchisee.
  - The franchisor is not concerned with the day-to-day operation of each outlet.
  - The franchisor's organisation is compact and can earn profits without involvement of high capital risk.
  - The network has the ability to grow rapidly.
  - The franchisor has fewer staff and fewer staff problems.
  - Each outlet is managed by the owner who will tend to be well motivated in order to succeed.
  - It provides wider and secured outlets for products and services.

- It enables the franchisors to serve national customers using their network of outlets.

In general, the franchisor reaps the benefits of the energy and commitment of the individual franchisees, which assist in the building of the goodwill and reputation of the brand and entire franchise operation. This enhanced goodwill and reputation increases the likelihood of success of the franchise operation, making it more attractive to prospective franchisees.

A number of franchisee outlets can develop and enhance the reputation of a franchise operation far more quickly than the franchisor could achieve on his/her own. In addition, the franchisor regularly receives feedback and input from all his/her franchisees, which can be utilised for the benefit of the other franchisees and the entire franchise operation.

End of Document