

FRANCHISING AS MODERN BUSINESS IN ROMANIA

Klara HORZINKOVA, PhD, ing.

Prague University of Economics

I. Franchising in Europe

Although franchising is mistakenly thought to be a twentieth century innovation, the concept has its first beginnings in the European feudal systems of the middle ages. When landowners began granting rights to peasants to use land in exchange for a fee and part of the profits, they were actually practicing a system that would evolve into franchising.

The franchise concept was further refined in the nineteenth century when German brewers allowed pubs to use the brewer's name to sell beer. The word "franchise" is of French origin, and basically means "a right or privilege." A franchisee is granted the right or privilege to use the franchisor's system, products and trademark.

The popular form of franchising we are familiar with today came into being in the 1950s, and was known as the "Business Format Franchise." It became an acknowledged business method that reduced risk and allowed the franchising company to grow quickly, and enabled the franchisee to buy a business based on a proven system.

One of the first well-known modern franchises introduced in the UK in the 1950s was the hamburger chain Wimpy. Many American franchises also got their European starts in the UK simply because of the common language. ServiceMaster, a Chicago-based upholstery and carpet cleaning franchise, sold a Master Franchise Licence for Europe in 1958. Two other franchises, Mr Softee and Lyons Maids, were also introduced in Europe during the 1950s. Although franchising took off in the 50s, the trend slowed in Europe during the next decade due to economic pressures and pyramid scheme allegations that tarnished the image of franchising.

KFC opened its first overseas unit in the UK in 1964. During the 1970s, several big name franchises, such as McDonalds, began opening stores in Europe. It was during the latter 1980s and early 90s that franchises really grew widespread in Europe. Companies such as The Body Shop, McDonalds, Tie Rack, Jani-King, Dominos, and Burger King all opened multiple franchise units in different countries across the continent.

In the 21st century, franchising has become an important part of many European economies. For instance, in the UK, the franchise industry grew twice as fast as the overall economy in 2006; and increased by 44 percent over the past decade, accounting for about £10.8 billion annually in sales.

The International Franchise Association currently cites Western Europe as one of the best places for international franchise development. And the world's largest franchise agrees -- Europe now produces more revenues for McDonalds than any other region, including the US. In 2007, McDonalds earned close to \$9 billion US in Europe, compared with less than \$8 billion in the US. The company is predicting this year's sales growth in Europe to be approximately nine percent, more than twice the expected US sales growth.

The future of franchising in Europe looks especially bright and varied as more companies recognise the value of the franchise concept, and entrepreneurial individuals continue seek out opportunities to own a business backed by a brand name.

II. Introduction

Franchising has grown rapidly in Europe in recent years and should continue to grow in the foreseeable future. In Europe, the franchise industry is largely unregulated. Unlike the United States, in which the offer and sale of franchises is regulated by the Federal Trade Commission and by the legislatures of half of the states, the European Union has yet to adopt a uniform franchise disclosure policy. The law of franchising in most individual EU member states is mainly controlled by traditional contract law and the concept of good faith. However, the trend appears to be toward the specific regulation of franchises.

Five member states of the European Union now have franchise-specific laws which impose pre-sale disclosure obligations on franchisors. France was the first European state to enact a law applicable to franchising in 1989.

Spain enacted its franchise law in 1996. Italy in 2004 and Belgium in 2005 were the latest EU members to enact laws regulating the sale of franchises. Romania, which joined the EU in January 2007, has had a franchise-specific law since 1997. In addition to these five national franchise disclosure laws, the Code of Ethics of the European Franchising Federation (EFF), which imposes pre-sale disclosure requirements on franchisors, is self-

enforced in seventeen European states where their national franchise associations are EFF members, and UNIDROIT, in 2002, adopted its Model Franchise disclosure Law.

III. Franchise Disclosure Laws of the European Union Member States

Romania

Romania, which became an EU member in 2007, enacted in 1997 its Government Ordinance No. 52/1997 Regarding the Legal Status of Franchise. Under the Ordinance, a franchise is defined as a marketing system where the franchisor grants to the franchisee the right to operate or develop a business, product, technology or service. In addition to requiring minimum provisions of the franchise agreement and regulating the post-sale franchisor-franchisee relationship, the Romanian act requires certain pre-sale disclosures. Among these disclosures are:

- a) the financial terms of the proposed franchise agreement, including royalties to be paid and purchases the franchisee is obligated to make,
- b) a description of franchisor's gained and transferable experience,
- c) the franchisee's area of granted exclusivity,
- d) the duration of the agreement, and
- e) the terms of the agreement governing renewal, termination and assignment.

There is no requirement under Romanian law for the registration or filing of franchises with the government.

IV. Disclosure requirements before signing a franchise agreement

Romanian franchise legislation stipulates that a franchiser must provide have enough information to the prospective franchisees in order to make a reasonably informed decision about whether to enter into a franchise agreement. The franchiser or the master franchisee need to provide a disclosure document to franchisees when they propose to enter into a franchise agreement. Usually a disclosure document must also be provided when renewing, extending or extending the franchise agreement so franchisees receive update details about the franchise.

Do you need to create disclosure documents?

Of course any franchiser needs to create a disclosure document before provide one to a prospective franchisee. The franchisee must read, sign and respect the document provisions; some franchisers may apply confidential provisions and they may claim damages if the prospective candidates violate provisions of the disclosure document. Since the franchise agreement has three phases: pre-contractual, contractual and post-contractual. The disclosure documents belong to pre-contractual stage of the franchise agreement. Signing a disclosure documents is not necessary followed by the signing of the franchise agreement.

Content and layout of disclosure documents

Usually a disclosure document must be in a specific format, respecting some minimum demands depending on the expected annual turnover of the franchise. The biggest is the level of the investment of the franchisee , the biggest is the level of the information the franchiser should provide; the purpose is that the franchisee can make a reasonably informed decision about the franchise .

When a franchiser needs to issue a disclosure document

The franchiser and the prospective candidates meet after the 2nd expresses his will of becoming a member of the franchise network. Of course, each franchiser has his own manner of testing and recruiting the franchisees. After a number of meetings the franchiser will issue a copy of a [disclosure](#) documents in a reasonable time. Even the current legislation is not very specific in other countries the standard period is of at least 14 days before they enter in a franchise agreement.

Disclosure relating to franchise agreements -Romanian Franchise Association

V. Romanian Franchise Association Code of Ethical Conduct: Extension and Interpretation

This Extension and Interpretation forms an integral part of the Code of Ethical Conduct adopted by the Romanian Franchise Association and to which its members adhere.

Application

1. This Code of Ethical Conduct forms part of the membership agreement between the Romanian Franchise Association and its member companies. It does not form any part of the contractual agreement between franchisor and franchisees unless expressly stated to do so by the franchisor in the franchise agreement. Neither should anything in this Code be construed as limiting a Franchisor's right to sell or assign its interest in a franchised business.

Disclosure

2. The objectivity of recruitment literature (Clause 3.2) refers specifically to publicly available material. It is recognised that in discussing individual business projections with Franchisees, Franchisors are invariably involved in making assumptions which can only be tested by the passage of time.

Confidentiality

3. For the generality of this Code of Ethical Conduct, 'know-how' is taken as being as defined in the European Block Exemption to Article 85 of the Treaty of Rome. However for the purposes of Article 3.4 of the European Code of Ethics it is accepted that franchisors may impose non-competition and secrecy clauses to protect other information and systems where they may be reasonably regarded as material to the operation of the franchise.

Contract Language

4. Franchisors should seek to ensure that they offer to franchisees contracts in a language in which the franchisees is competent.

Contract Term

5. In suggesting in Article 5.4 of the European Code of Ethics that the minimum term for a franchise contract should be the period necessary to amortize those of a franchisee's initial investment which are specific to the franchise, it is recognised:

(a) that for a minority of the largest franchise opportunities amortizing initial investments may not be a primary objective for the franchisees. In such cases the objective should be to adopt a contract period which reasonably balances the interests of the parties to the contract.

(b) that this section could be subject to national laws concerning the restraint of trade and may need to be met through renewal clauses.

Contract Renewal

6. The basis for contract renewal should take into account the length of the original term, the extent to which the contract empowers the franchisor to require investments from the franchisees for relinquishment or renovation, and the extent to which the franchisor may vary the terms of a contract on renewal. The overriding objective is to ensure that the franchisee has the opportunity to recover his franchise specific initial and subsequent investments and to exploit the franchised business for as long as the contract persists.

Adoption

7. This Code of Ethical Conduct comprising this Extension and Interpretation and the European Code of Ethics for Franchising was adopted by the Romanian Franchise Association, replacing its previous Code of Ethics on 30th August 1990, subject to a transitional period for full compliance ending 31st December 1991. During the transitional period members of the Association are nonetheless required to comply at least with the Code of Ethics previously in force. In October 1991 the Association agreed with the European Franchise Federation some amendments to the Code agreed in August 1990 and at the same time extended the transitional period to full compliance to 31st December 1992.

VI. Disclosure Requirements in The Pre-contractual Phase

In the pre-contractual phase, a franchisor is required to provide the prospective franchisee with certain information through a so-called “[Disclosure Document](#)”. The purpose of such disclosure is to enable the franchisee to make an appropriate decision regarding whether or not to enter into the franchise relationship. The Disclosure Document must be submitted before the franchisee undertakes any legal obligations with respect to the proposed business. The legal provisions in force do not provide for a specific form under which the Disclosure Document must be issued. Nevertheless, the franchise law states that such document must include, among other things, a description of the franchisor’s experience in the proposed business; information on the financial conditions in the franchise agreement, i.e., the initial royalty or entry fee to the franchise network; the scope of any exclusivity arrangement; and information on the duration, renewal conditions, resolution and termination of the franchise agreement. These matters are provided by the franchise law as the minimal information that must be disclosed by the franchisor. Additional information should also be provided to the extent that such other information would be of interest to the franchisee in making its business determination. No specific penalties are stipulated in the law for the failure to provide such information. However, the franchisee may bring suit against the franchisor for damages caused as result of such non-disclosure or an incomplete disclosure. The burden of proof of any damage lies with the franchisee. Theoretically, criminal liability for misrepresentation is also possible.

VII. Franchise legislation in Romania

Franchise legislation in Romania: Romanians have developed into brand conscious consumers during the eleven years that have passed since Romania enacted a franchise law. The market has almost fully evolved, and the pioneering period in franchising during which major companies entered the market only for market testing – first performing distribution operations (Coca Cola) or establishing a subsidiary (McDonald’s) and only afterwards developing their franchise concepts – ended some time ago. Today, hundreds of franchises are operating in Romania and analysts see the Romanian franchise market reaching € 3 billion by 2010

With a population of over 22 million inhabitants, Romania represents a very large market within the European Union. Romanian consumers are highly receptive to and demonstrate an affinity towards international brands. Even following the fall of communism in 1990, Romanians clamoured after name brand designer clothing. Over time, many of the well-known franchises established some form of operation in Romania and most of those have become success stories. The idea of “buying” an already successful business and “selling” a famous name has been heartily embraced by Romanian entrepreneurs. But so far, franchising has developed mainly in retail, services – hotel accommodations, restaurants, catering and, to a lesser extent, in the services industry. There still is room enough for firms who are interested in entering the Romanian market. The Romanian Franchise Association (A.R.F.) is supportive of new franchises, and seeks to improve both the legal and the social conditions for the development of such operations through market studies and research. Indeed, the Internet contains sites that list franchisors looking for franchisees in Romania.

When franchising in Romania, bear in mind that pursuant to the Romania’s franchise law, a franchisor must be the holder (i.e., either owner or holder of rights) of the applicable intellectual or industrial property in order to register the trademark with the Romanian State Office for Inventions and Trademarks. Note that the registration of a trademark in Romania may take up to 16 months.

There are two registration requirements: the franchise agreement or a short form license agreement must be registered with the Romanian State Office for Inventions and Trademarks and, in certain circumstances, based upon the parties’ turnover and market share in Romania, with the Romanian Competition Council, in order to obtain either a block/individual exemption or a non-objection decision for the respective franchise agreement. The franchise law also provides that franchisor must disclose certain information to the franchisee. The law is not specific with regard to the kind of information to be disclosed, but provides that the information must be sufficient to enable a franchisee to draft a financial plan. In practice, the disclosure of the information referred to in the Uniform Franchise Offering Circular is sufficient.

Romania’s franchise disclosure requirements and its regulatory framework are set forth in Government Ordinance No.52/1997, as amended by Law No.79/1998 (hereinafter referred to as the “Franchise Law”). There are specific

provisions applicable to the pre-contractual, contractual and post-contractual relationship between the franchisor and the franchisee and those elements are described in this article.

VIII. The Franchise Agreement

The trademark of the franchisor is, of course, the key component in the relationship that differentiates a franchise from many other businesses. The franchisor's trademark is the symbol of the identity and reputation of the franchise and warrants the quality of the product/service/technology provided to consumers. The transfer and control over know-how – among other things, the methods used to obtain the quality associated with the mark — is designed to ensure the provision of a uniformly similar set of products, services or technology which consumers have come to associate with the trademark. In other words, a McDonald's restaurant should look basically the same, and its products should appear and taste similar, to what is offered in Baku, Bucharest or Brooklyn, allowing only for modest variations of taste by culture.

According to Romania's franchise law, the franchise agreement must clearly define the obligations and responsibilities undertaken by the franchisor and the franchisee, as well as any other clauses defining the forms of cooperation between the parties. Irrespective of the nature of the franchise, the franchisor must agree to perform certain functions for the franchisee such as providing managerial consultancy, commercial and technical assistance, training of employees of the franchisee, and granting the right to use certain know-how or a specific trademark or other intellectual property rights. Franchise agreements may include non-compete clauses in order to protect the transferred know-how.

VIII. Romania in numbers

Romania ranks third in the top of countries with the most new brands having entered their markets in 2010, shows a study of the real estate consultancy firm CBRE, which includes over 300 retailers in 73 countries worldwide. This year, retailers like Gucci and Emporio Armani entered the Romanian market, having opened stores on Calea Victoriei, while H&M also opened its first stores in Romania reports Romanian Business Insider.

Local business franchise reached 1 billion. Growth Forecast: 10%



Ready for sale cheapest cost around 1,000 Euros

In addition to the approximately 350 franchises present in Romania we could see more business soon "cloned" in areas such as retail or fast food. Constantin Anton, president of the Romanian Association for Franchise, said the budget for a business franchise by the Romans is between 15,000 and 20,000 euros.

Last year in franchise businesses stagnated at about 1 billion and this year could soar to 1.1 billion euros, consider Constantin Anton, president of the Romanian Association for Franchise (ARF). He says that market value is lower than previously expected.

"If they would have continued the pace of 2008-2009, the figures were at least 25% -30% higher" scores Constantin Anton. Romanian President Franchise Association said that demand for franchises generally recorded after 2008 a slight stagnation, and in all areas were marked, overall, only minor increases. "Cafes and restaurants sector had the same trend, although the potential franchisees predominantly targeting this area, including fast food," notes Anton Constantine.

Budget of 20,000 Euros to the franchise

To go on a business recipe already checked, the Romans are willing to invest in franchises that do not exceed 15000-20000 euros, given the current economic environment, says president of Romanian Association franchise. The most recent fair held in Bucharest franchise last month, the cheapest franchise was "washing the car park," which cost about a thousand euros. At the opposite pole stood Genomed healthcare franchise, master franchise which exceeds 200,000 euros. "Probably two or three months will complete the master franchise agreement for franchise Genomed Romania," said Constantin Anton. According to the Romanian Association for Franchise Chairman, there are about 130-150 franchises Romanian and foreign franchise somewhere 200-220. Among the Romanian brands that have chosen to expand the franchise include: Romstal, Jolidon and Musette. Also, Dragos Petrescu, CEO City Grill, said the "Fin.ro" as long for the next five years, the objective of City Cafe is to open 10 units (both in the capital, and in cities over 200,000 inhabitants) partners through franchisees. Last year, the business group's City Grill were estimated at 16 million and this year expects a 15% increase in business.

Steps for Success

Constantin Anton, president of the Romanian Association for Franchise, explained what should be done for more export business out. Anton pointed and some steps that a franchise owner would have to follow to be successful in another country "to register the brand in the country where you want to activate and check if that State law has certain restrictions. To do a market study as to whether the franchise that can integrate culture and traditions, and competitors to study the extent possible, to find out about their profitability and, if not profit, to establish the reasons. Also, prices of products / services must be in accordance with the standard of living in that State, must make the appropriate training and take great care in selecting external partners ".

Extended major franchise brands

- McDonald's parent company entered the market in 1995 and reached in Romania 63 units, operating a McDonald's franchise amounted to 500,000 Euros
- Ikea was one of the most expensive franchise to the Romanian market, with investments of nearly 36 million, but now returned to the Swedish company
- Pizza Hut and KFC have been brought on the Romanian market and Nicolae Badea Puiu Popoviciu. Investing in a KFC restaurant reaches 500,000 Euros

Before the crisis

In 2008 there were nearly 400 franchises, of which 155 local

Sources:

Franchise Magazine: "Franciza o afacere de succes"

A.R.F.- Romanian Franchise Association

www.franchiseromania.com

www.13fm.ro

www.francizor.ro