

# SERVICE LAW FIRM

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## FRANCHISE AGREEMENTS

Being in business for yourself can be a demanding proposition. All aspects of the business are the responsibility and under the control of the owner, including marketing, advertising, inventory control, sales and production. In addition, the business must be managed properly to succeed. In the case of a person who is not comfortable with being totally responsible for all aspects of their own business, a franchise is an option to assist in operational management.

Franchise agreements generally provide for the division of control over functional areas of the business between the franchisor and the franchisee (the Head Office). Usually, there are fees payable upon purchase of the franchise, fees payable on an on-going basis, (sometimes based upon a percentage of gross sales), and contributions to various activities designed to increase the profile of the franchise system. These fees will pay for the functions of the overall business that are performed by the franchisee. They also pay for the internal administration and profit of the franchisee.

Commonly, a franchise agreement will provide that the franchisee will control group advertising for all members of the franchise chain and the members must pay for the cost of advertising. Group advertising has many benefits including reaching a broader number of potential consumers, many of whom may not be within the immediate geographic area. In addition, group advertising provides the potential for volume discounts on the cost of advertising and access to media which is beyond the cost of most small businesses. A good example of this is seen with the television advertising carried out by many real estate franchise systems. No single real estate office could easily afford television advertising.

With group advertising, however, comes a loss of control over the cost of advertising and its perceived effectiveness on the local level. Franchise agreements commonly permit advertising within an area which may be quite large. Advertising dollars paid by a Barrie franchise might, for example, be spent on advertising in the Ottawa area. This might or might not be helpful, depending on the nature of the franchise.

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Many franchise agreements provide for the training of new members. For someone new to a business, this can provide a valuable resource regarding the setup and ongoing management of the particular business. While training does not guarantee that any new business will be a success, it is in both party's interest that the relationship be a success. The quality of the training can vary widely among different franchise systems and should be carefully investigated by anyone contemplating entry into a franchise agreement.

Some franchise systems, usually in the retail sector and particularly of the pet store type, require a member owner to purchase all their supplies, including inventory, from head office. Since the gross sales margin is determined by the mark up on inventory, control of the cost of inventory can amount to a hidden franchise fee. It may be possible in this type of agreement for the head office to charge more than the fair market value of the inventory to each store owner. Any franchise agreement must be carefully reviewed for hidden costs of this type.

Some franchise systems do not permit two franchisees to be located within the same geographic area. This has the effect of ensuring that each franchisee has a reasonable chance of establishing a loyal customer base without undue competition from another franchisee. Some do not. Clearly, this must be considered when purchasing a franchise. Two identical franchises located too close together, in competition, will hurt both, while the franchisor may benefit from the increase gross sales revenue and the franchise purchase fees.

An evaluation of any franchise agreement from a business perspective can be made by answering several questions. What do I gain? What do I give up? What will it cost? A careful evaluation must be made, however, to give the best possible chance of success to the new enterprise.

We hope the above general information has been helpful. Each decision to be made concerning a franchise is dependant upon the facts of the situation, the business itself and the franchise agreement which is under consideration. The Service Law Firm will be pleased to assist in determining the rights, obligations and benefits of the agreement to give the franchisor a clear understanding of the contract.