

# Franchising

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# FRANCHISING – a winning formula

Franchising is a business model which has proved to be successful and is enjoying increasing popularity throughout the world. In America, franchising is responsible for over forty percent of all retail sales. Notwithstanding the success of franchising globally, franchising in South Africa has not yet reached its full potential. As a business model, it only really started taking off from the 1960's onward.

This slow start has however changed as businesses have realised the enormous potential of franchising and how this can be used as a highly successful business model. A successful franchise will combine the strength and economies of scale of a large operation, while the owner/manager structure allows each franchisee to enjoy the fluidity of the entrepreneurial model, benefiting from flexibility and adapting to local knowledge. Franchising offers people the

freedom to own, manage and direct their own business, with the support of an established business. It also provides a means for companies to expand effectively without incurring the high overheads and management difficulties often associated with establishing a branch network.

The potential of franchising to be used as a highly effective means of empowerment has been recognised by government which has stated its policy of supporting franchising and putting its resources behind this model. This together with the success enjoyed by franchising globally on account of, inter alia, its ability to harness the strength of economies of scale and the entrepreneurial owner/manager model, ensures that franchising is looking to have a promising future in South Africa.

## **What is franchising?**

Although there is reference in literature to various forms of

franchising, ranging from business franchises to service franchises, this has done little more than add to a sense of confusion as to what exactly franchising is. The International Franchise Association has however come up with a useful definition of franchising and defines this business model as “a contractual relationship between the franchisor and the franchisee in which the franchisor offers or is obliged to maintain continuing interest in the business of the franchisee in such areas as know-how and training; [in which] the franchisee operates under a common trade mark, format or procedure owned or controlled by the franchisor, under which the franchisee has made, or will make, a substantial capital investment in his business from his own resources”.

In essence franchising consists of granting a licence to use certain trade marks and the goodwill associated with such marks in conjunction with other intellectual property, for example a patent or confidential knowledge vesting in the know how underlying the

business system. This is used in exchange for, typically, the payment of a fee and an undertaking to comply with certain obligations, including a strict compliance with the franchisor's business system.

### **South Africa: Legal Framework**

In South Africa, franchising is not in itself regulated by any form of legislation. There has been talk for some time of legislation being introduced to regulate franchising. This however has not yet come to fruition. While certain draft documents and discussion papers have been prepared and lodged for discussion within parliament, current indications are that this process has been shelved for the moment. There is a probability that, like other jurisdictions such as America, franchising will indeed be regulated by legislation, but the exact form of such regulation remains to be seen.

The lack of franchise specific legislation does not however mean that franchising is a free for all. As a franchise is essentially an agreement between the franchisor and the franchisee, the common

law provisions relating to contracts are applicable and govern the agreement.

In addition to the common law, there are a number of statutes which have a direct bearing on franchise agreements. These statutes include the applicable intellectual property law statutes (ie the Trade Marks Act, the Patents Act, Designs Act and Copyright Act) which regulate the intellectual property being used by the franchised system.

There are other statutes which have a general bearing on franchise agreements. These statutes include the Competition Act, the National Credit Act and the Unfair Business Practices Act.

Each of these statutes can have a direct bearing on the agreement and must be taken into account when considering a franchise agreement.

### **Recent Developments**

A typical example of how such statutes affect franchises is the Competition Act. This is a relatively new act and jurisprudence surrounding this act

is still developing. However it has already been felt in the franchising industry. The well-known cases of 7 Eleven franchises and Ilatile have confirmed that the Competition Act is going to be increasingly felt in the franchising industry. These cases involved minimum price fixing, a practice which is common in the franchise industry, but which is one of the practices which is absolutely forbidden by the Competition Act. Other common practices in which the Competition Act is going to make its presence felt will include the division of markets into geographical territories and exclusive supply agreements.

As mentioned above, Competition Act jurisprudence is developing, but it is important to ensure that when drafting franchise agreements due regard is paid to its provisions and to the provisions of other acts.

### **The importance of a well-drafted agreement**

In addition to statutory considerations, it is important to bear in mind that franchising

essentially allows the granting of rights which belong to the franchisor for the use by other parties. As is always the case with the granting of rights to other parties, it is imperative that the rights and obligations of each party are properly catered for in the agreement. To this end, it is essential to ensure that the rights

being obtained by the franchisee are appropriate in the context of the agreement. It is also imperative to ensure that the obligations of each party are clearly defined and recorded. Failure to do so will almost certainly lead to disagreements between the parties and to an unsuccessful model.

Due to the specialised nature of the franchising model, it is imperative to ensure that the appropriate expert advice is obtained. We have substantial experience in franchising and are well positioned to assist both franchisors and franchisees with the setting up and entering into of franchise operations. We also have ties with the Franchise Association of South Africa and can assist with giving advice in this regard. With our strong intellectual property background, we are able to complement the statutory and commercial requirements of franchising with specialised advice on the intellectual property aspects underlying the franchise operation.

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