

# A Glossary of Franchise Terms

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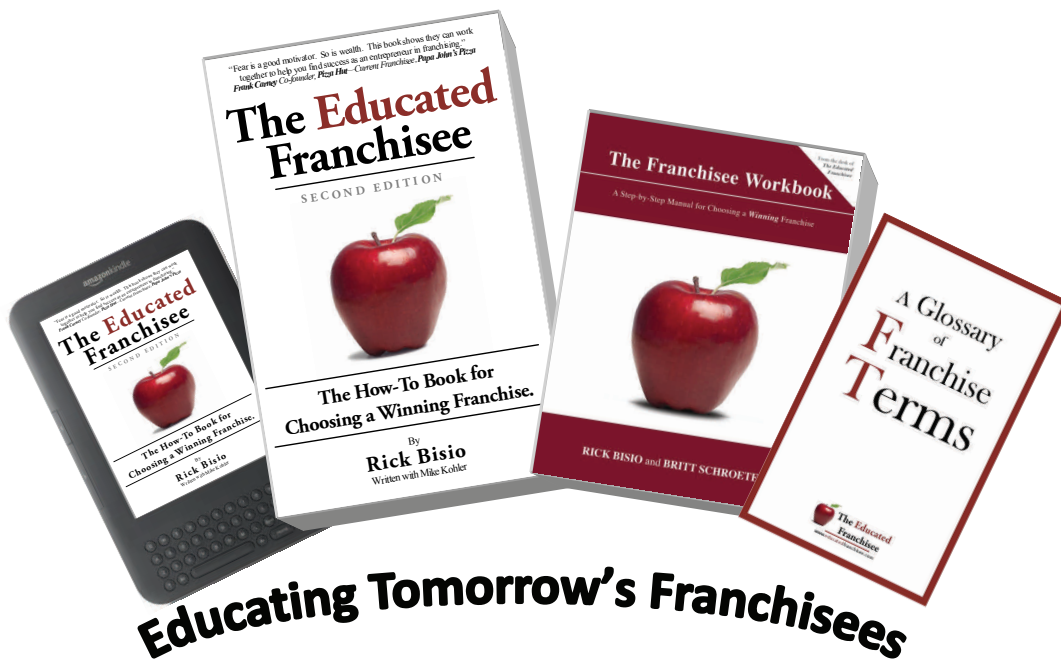
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Quality is never an accident;  
it is always the result of  
high intention, sincere effort,  
intelligent direction  
and skillful execution;  
it represents the  
wise choice of many alternatives.

~Unknown

# **Glossary Sources**

**Thanks must be given for the substantial assistance received from**

**The International Franchise Association  
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**The Educated Franchisee  
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**Additional sources include, but are not limited to,  
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# Glossary of Franchise Terms

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The following glossary of franchise terms has been meticulously constructed to be as accurate as possible. While some terms are based on generally accepted definitions, other terms may be subject to differing interpretations and uses. Franchising is an evolving and changing business format and, as such, the terminology used by its practitioners is similarly fluid. The intent of this glossary is to give the reader an introduction to some of the language used in franchising. It is not intended to be all inclusive but merely one tool to understanding this unique business format. We hope you find it useful.

## A

### **Acknowledgement of Receipt**

The final page of a **Franchise Disclosure Document (FDD)**, which, once signed and returned, confirms to the **franchisor** the date you received the document.

### **Advertising Co-op**

A participatory body of **franchisees**—occasionally including the **franchisor**—that contributes money to a common fund to pay for regional or national advertising programs. Administration of **advertising co-op** funds varies from company to company. In most cases a committee of **franchisees** administer the fund. Alternatively, a special advertising committee made up of both **franchisees** and the **franchisor** may oversee use of the funds.

### **Advertising Commitment**

This is an amount that a **franchisee** commits to spend on advertising and promotion in the local market. These monies are con-

trolled by the individual **franchisee** and used to promote the **franchisee's** individual business.

#### **Advertising Contribution**

The monies that a **franchisee** is required to contribute to the **advertising fund** or the **advertising co-op**. These funds are used to pay for system-wide advertising and promotional expenses. The manner in which **advertising contributions** are made varies from company to company. Many **franchise agreements** specify a percentage of **gross sales** to be spent on advertising; the breakdown of expenditures for local, regional, and/or national advertising may also be specified.

#### **Advertising Fee**

Please see "**Advertising Contribution.**"

#### **Advertising Fund**

Similar to an **advertising co-op**, this fund is administered and controlled by the **franchisor**.

#### **Agent**

A person authorized by another (often called a "principal") to act on his behalf.

#### **Angel Investor**

An individual or group of individuals who provide capital for a business start-up, usually in exchange for convertible debt or ownership equity. **Angel investors** invest their own personal funds, unlike **venture capital** firms that manage the pooled money of others in a managed fund. In some cases, if a family member or a friend were to lend you money to start a business, they also would be referred to as an **angel investor**.

#### **Antitrust Law**

Laws adopted to outlaw or restrict business practices considered monopolistic or that restrain trade. In the U.S., the principal **antitrust laws** are the Sherman Antitrust Act (enacted in 1890 and frequently amended), the Clayton Act (originally adopted in 1914), the Robinson-Patman Act (passed in 1936 to add price-

discrimination prohibitions to the Clayton Act), and the Federal Trade Commission Act (also adopted in 1914). Some states have also adopted **antitrust laws**, such as the Donnelly Act in New York. Outside the U.S., antitrust laws are often referred to as “competition” laws.

#### **Approval/Consent**

In **franchising** this is a provision within the **franchise agreement** requiring that a party who wishes to act must obtain the consent or approval of the other party. For example, the **franchise agreement** may require that before the **franchisee** can transfer interest in the **franchise**, he/she must obtain “**approval/consent**” of the **franchisor**.

#### **Approved Supplier/Vendor**

An approved supplier/vendor is an entity that has been approved by the **franchisor** to sell products and/or services to **franchisees** of its system. Items sold by **approved suppliers** may include equipment, ingredients, and other materials or items for use in operating the franchise business. The **franchisor** will generally approve several suppliers for each item and the **franchisee** may purchase the items from any of the **approved suppliers**. In some instances, a **franchisor** approves only one **approved supplier** of a specific product (i.e., a soft drink supplier) for purposes of system-wide uniformity. Also see “**Designated Supplier/Vendor.**”

#### **Arbitration**

In disputes between a **franchisee** and a **franchisor**, submitting the dispute for determination to private, unofficial persons or “arbitrators.” Agreement to arbitrate must be stated, for example, in the **franchise agreement**, and **arbitration** findings are binding on both parties. A court’s only basis for review of an arbitrator’s decision is whether it was arbitrary, capricious, and an abuse of the arbitrator’s discretion or beyond the arbitrator’s authority.

#### **Area Developer**

The **franchisor** awards a single **franchisee** the right to operate more than one unit within a defined area, under a **development agreement** and based on an agreed-upon **development schedule**.

### **Area Representative**

A type of **franchisee** that can own and operate **franchise outlets**, represent the **franchisor** in selling new **franchises**, and provide on-going local support to existing **franchisees** in a designated market. The **area representative** normally receives a portion of the **royalty fees** (and possibly the up-front **franchise fee**) payable by the **franchisees** to the **franchisor**. **Area representatives** may operate in a variety of geographical configurations, including metropolitan areas, a single state, or a combination of states. The **area representative** is not a party to the **franchise agreement**, which is between the **franchisor** and the **franchisee**. See, for comparison, “**Master Franchisee**.”

### **Assignment**

Contractual authority of a **franchisee** to give away, sell, or otherwise transfer or dispose of all or certain ownership rights in the **franchise agreement**, the **franchised outlet**, and/or interest in the legal entity that owns the **franchise**. **Assignment** rights vary from **franchisor** to **franchisor** and may include the right to sell the business and transfer the **franchise agreement** to the buyer; or to transfer ownership and rights to the family; and/or for the estate to sell the **franchise** upon the owner’s death or disability. Virtually all **franchise agreements** limit **assignment** in one way or another.

## **B**

### **Bona Fide Wholesale Price**

Defined in the **Federal Trade Commission’s Franchise Rule** and one of three terms employed in defining a “**business format franchise**.” Refers to the price of goods or services for use by or to be made available for resale by the **franchisee**, the price of which is established in good faith without fraud or deceit. The **FTC Rule** provides that payments for the purchase of reasonable amounts of inventory at **bona fide wholesale prices** for resale or lease are not “required payments” and therefore are not considered the payment of a “**franchise fee**.” Also see “**Franchise**.”



**Breakaway Franchisee**

A **franchisee** who has unilaterally terminated their **franchise agreement**. Obligations of a **breakaway franchisee** may include some or all of the following: payment of substantial damages to the **franchisor**, resale of the business to the **franchisor**, or an obligation to abide by a post-term, non-compete covenant.

**Bundle of Rights**

All those rights and obligations that pass to the **franchisee** under the terms of a **franchise agreement**. These may include such items as right to use the **trade name**, right to knowledge of **trade secrets**, right to use the format of the business, right to build equity, and right to manage day-to-day operations in the prescribed manner.

**Business Broker**

An intermediary who manages the sale and/or purchase of an existing **franchised** business. Brokers can represent either sellers, buyers, or both. A **business broker** commonly, but not always, has a “**Fiduciary Duty**” within the relationship.

**Business Format Franchising**

The **franchising** system wherein the franchisee buys from the **franchisor** a total blueprint for doing business. Usually included is the license of a **trade name**, the **trademark**, access to **trade secrets**, and a clearly defined method and set of guidelines for conducting the business. Occasionally referred to as “**pure**” or “**comprehensive**” **franchising**.

**Business Opportunity Laws**

Laws regulating the sale of non-franchised “business opportunities.” States that have such **business opportunity laws** typically exempt **franchise** programs that have federally registered **trade or service marks**, but some nonetheless require **franchisors** to file some form of application to claim that exemption. Some common business opportunities include vending machines, worm farming, envelope stuffing, and in-home mail order enterprises. In 2007, when it issued amendments to **the Franchise Rule**, the **FTC** also proposed a separate Business Opportunity Sales Regulation.

**Business Plan**

A **business plan** is a formal statement of a set of business goals, the reasons why they are believed attainable, and the plan for reaching those goals. It may also contain background information about the organization or team attempting to reach those goals.

#### **Business Valuation**

The practice of valuing an existing business. There are a large number of approaches to **Business Valuation**, including but not limited to Multiple of Earnings, Fair Market Value, Book Value, Replacement Value, Present Value, Future Value, Going Concern Value, Asset Value, Liquidation Value, etc.

#### **Buy-back Option**

A term of the **franchise agreement** wherein if the **franchisee** goes out of business the **franchisor** retains the right to buy back all assets at a pre-agreed price. The **buy-back** is an option that the **franchisor** retains and it is not a promise.

## C

#### **Camera-ready Advertising**

Artwork and typeset materials that are ready for printing. **Camera-ready advertising** is for use in print media (newspapers, magazines, store signs, handbills, flyers, brochures, etc.). Since the cost of producing professional, **camera-ready advertising** is generally shared by all **franchisees**, the cost per **franchisee** is usually quite reasonable.

#### **Cash/Initial Cash Required**

One of a number of terms—the meanings of which vary from **franchisor** to **franchisor**—that are used to describe cash monies that the **franchisee** must spend prior to opening for business. Any of the following terms may be used in this context: cash required, initial cash required, **investment**, down payment, **equity investment**. Information concerning the **initial investment** that a prospective franchisee can expect to incur can be found in Item 7 of the **FDD**.

**Cash-flow Projections**

A spreadsheet that shows a month-by-month forecast of cash flow coming into the business and expected disbursements, including payroll, rent, insurance, debt, etc. A person considering entering into a business, including a **franchise**, should carefully examine their **cash-flow projections** to determine whether there will be adequate **working capital** for the new business.

**Commitment Agreement**

Please see "**Letter of Intent.**"

**Company-owned Outlet**

In a **franchised** system, the outlets that are owned by the **franchisor** (or, sometimes, its affiliates).

**Competing Operation**

When a **franchisee** establishes, operates, owns, or has financial interest in any business that offers products or services the same or similar to those of the **franchise**, the **franchisee** may be said to have a "**competing operation.**" Many **franchise agreements** restrict all **competing operations** during the term of the **franchise**; they may also restrict any competing activity or business after the term within a specific area and for a limited period (those parts of the **franchise agreement** are referred to as the "**non-compete clauses**").

**Comprehensive Franchising**

Please see "**Business Format Franchising.**"

**Conversion Franchising**

The process by which existing independent businesses or dealers within an industry become **franchisees** when they assume the **trade name** and **trade dress** of the **franchisor**. **Conversion franchising** has been particularly widespread in the real estate industry.

**Copyright**

Generally, the exclusive right of the author or creator to protect his or her creation, such as a movie, book, music, or other expres-

sion. As it relates to **franchising, copyrights** most often apply to confidential written material (such as the **operating manual**, proprietary recipes, and the like). Under a **franchise agreement**, the **franchisor** usually licenses the **franchisee** to use those **copyrighted** materials in the operation of the **franchised** business for the term of the agreement.

#### **Covenant of Good Faith / Fair Dealing**

At the heart of a **franchise** is an agreement that sets out the essential contractual obligations governing the relationship between **franchisor** and the **franchisee**. The **franchise agreement**, however, cannot spell out all the obligations that a **franchisor** may owe the **franchisee**, and it has been argued that the **franchisor** also has an implied duty of “fair dealing” not contained explicitly in the **franchise agreement**. Courts usually find that the implied **covenant of good faith and fair dealing** cannot be used to contradict clear provisions in an agreement.

#### **Covenants Against Competition**

The clause or term of a **franchise agreement** in which the **franchisee** agrees not to engage in or maintain any interest in a business activity that competes with the **franchise** business. Also see “**Competing Operation.**”

## **D**

#### **Decision-making Matrix**

A knowledge-based tool found in *The Educated Franchisee* and this workbook to help support decision-making. This tool is focused on primary criteria and collected data and is central to a logic-based, decision-making approach.

#### **Default**

The neglect or failure of either party—**franchisee** or **franchisor**—to fulfill obligations and/or take the steps required under the **contract**.

**Deferred Balance**

A sum of money that the **franchisee** owes to the **franchisor**. A **deferred balance** is generally some remainder of the total amount initially paid for items such as equipment, fixtures, inventory, or construction/rent.

**Demographics**

A range of factors that may influence consumer behavior in a specific trade territory such as age, income, home prices, and socio-economic conditions.

**Designated Supplier/Vendor**

A designated entity from which **franchisees** are required to purchase certain products and/or services necessary to operate a **franchise** business. This usually applies to proprietary products and/or private label products manufactured to the **franchisor's** standards and specifications, but might also apply to other products that the **franchisor** believes are critical to the success of the **franchise** system. Also see "**Approved Supplier/Vendor.**"

**Development Agent**

Please see "**Area Representative.**"

**Development Agreement**

A term used to describe the agreement traditionally used to grant multi-unit **development rights** to **franchise developers** or **multi unit franchisees**. In the **development agreement**, the **franchisor** grants semi-exclusive "**development rights**" to a developer, which in turn agrees to establish a specific number of **franchised** units within a certain geographic area (called a "development area") in accordance with a predetermined "**development schedule.**" Before the developer opens each **franchised** business, it typically is required to sign a **franchise agreement** for that **franchise**. The developer typically pays a "**development fee**" to the **franchisor**, a portion of which may be credited toward the **initial franchise fee** due under the unit **franchise agreements**.

**Development Fee**

Please see “**Development Agreement.**”

**Development Rights**

Please see “**Development Agreement.**”

**Development Schedule**

Please see “**Development Agreement.**”

**Disclosure Document**

Currently required under the laws of fifteen states, a **disclosure document** is provided by the **franchisor** to a prospective **franchisee**. The document contains information about the **franchisor**, the **franchise** being offered, and the terms and conditions of the legal relationship into which the **franchisee** will enter. The state agency that administers the **franchise** laws typically reviews the document and other pertinent materials the **franchisor** will use in promoting the sale of the **franchise**. Also see “**Franchise Disclosure Document .**”

**Discovery Day**

An event set up by the **franchisor** so that potential franchisees may learn more about becoming a **franchisee**. A **discovery day** typically takes place at the **franchisor's** headquarters and is often the final step in the **due diligence** process. It provides the opportunity to meet the management team, support team, and trainers face-to-face. Occasionally called “Meet The Team Day” or “Open House.”

**Discrimination**

Treating one **franchisee** differently from another. A number of statutes and legal cases restrict a **franchisor's** ability to discriminate among businesses that are similarly situated.

**Distributor**

An individual or company through whom a manufacturer sells his products to retailers and/or consumers. Conventional **distributors** may handle several lines of competing products, whereas franchised distributors typically only handle the products of one **fran-**

**chisor.** Franchised distributors operate exactly as other independently-owned, franchised businesses, receiving training, management, and advertising support from the **franchisor**.

**Downpayment**

Please see “**Cash/Initial Cash Required.**”

**Dual Distribution**

When a **franchisor** operates **company-owned outlet** on the same marketing level as its **franchisees**.

**Due Diligence**

Usually undertaken by investors, but also customers, **due diligence** refers to the process of making sure that someone is what they say they are and can do what they claim; i.e., investigation of a business (e.g., Does the product or system really work? Does the franchise really have customers?).

## E

**Earnings Claim**

Please see “**Financial Performance Representation.**”

**Encroachment**

Any **franchisee**—or the **franchisor**—attempting to sell products or services within an area of territory that has been assigned to or designated exclusively for another owner.

**Entrepreneur**

A person who is willing to assume the responsibility, risk, and rewards of starting and operating a business.

**Equity Interest**

Any legal ownership of the **franchise** business or the corporation that owns the **franchise** business.

**Estimated Initial Investment**

A detailed listing of all fees and expenses you should expect to incur in starting a **franchised** business. This listing represents the total amount that a **franchisee** would need to pay or get financed, including fees paid to the **franchisor** and goods/services purchased from third parties. This estimate can be found in Item 7 of the **Franchise Disclosure Document**.

**Exclusive Territory**

A territory assigned to a **franchisee** within which a **franchisor** agrees not to operate a **facility** (or grant a license to another party to operate a **facility**) that is the same as the franchised business, under the same marks, and under the same system. Most **franchisors** reserve rights with respect to other methods of distributing products or services (such as internet sales). Not all **franchisors** offer **exclusive territories**.

**Expiration of Term**

In a **franchise agreement**, the date upon which the contract expires if it is not renewed.

# F

**Facility**

Please see "**Site**."

**FDD**

Please See "**Franchise Disclosure Document**"

**Federal Trade Commission (FTC)**

An independent agency of the United States government headed by five commissioners, each of whom is appointed to office by the president and confirmed by the U.S. Senate. The president has the authority to designate one of the commissioners as chairman of the agency. The **FTC** has an extensive staff and is charged with administering and enforcing the **Franchise Rule** as well as general prohibitions against unfair and deceptive practices; for example, involving advertising.



**Fiduciary Duty**

A requirement that a person act toward others and the public with the watchfulness, attention, caution, and prudence that a reasonable person in the circumstances would use.

**Field Representative**

Please see "**Franchise Representative.**"

**Financial Forecast**

Please see "**Financial Performance Representation.**"

**Financial Performance Representation**

Any oral, visual, or written representation to a prospective **franchisee** or for general dissemination in the media which states or suggests a specific level or range of potential or actual sales, income, gross, or net profit. This information must be provided in Item 19 of the **Franchise Disclosure Document**. Previously called "**Earnings Claim.**"

**First Personal Meeting**

Historically the **Federal Trade Commission** required **franchisors** and their sales representatives to provide the **Federal Trade Commission Disclosure Document** to the prospective **franchisees** during the **first personal meeting**. This requirement was eliminated in the 2007 amendments to **the FTC Rule**. Two states have retained this requirement. Please see "**Reasonable Request.**"

**Forum Selection**

A term in the **franchise agreement** that designates the state and court in which disputes are to be litigated.

**Fractional Franchise**

A relationship that is exempted from the **FTC Rule** because the **franchisee** or its principals have had more than two years of prior experience in the **franchised** or similar business; and wherein the **franchisor** or the **franchisee** anticipates that the **franchisee's** sales arising from the **franchise** would represent no more than 20% of

projected volume in the first year of the relationship. Some **state franchise laws** also have a **fractional franchise** exemption.

### **Franchise**

The **FTC Franchise Rule** defines a “**franchise**” as an arrangement whereby a **franchisor** grants **franchisees** the right to operate a business that: 1) is identified with the **franchisor's trademark**; 2) is subject to the **franchisor's** significant control and/or assistance; and 3) in exchange for which, the **franchisee** pays a “**franchise fee**” to the **franchisor** or its affiliate. Most **state franchise laws** adopt a similar definition (except in New York, where any combination of elements 1 and 3, or elements 2 and 3, are enough to satisfy the state law definition of “**franchise**”).

### **Franchise Agreement/Contract**

The legal document that sets forth the rights and obligations of the **franchisee** and the **franchisor**. Commonly included is information about territory, location, training, management, **renewal**, **termination**, dispute resolution, suppliers, **quality control**, product standards, advertising, etc.

### **Franchise Broker**

Please see “**Franchise Consultant.**”

### **Franchise Company**

Please see “**Franchisor.**”

### **Franchise Consultant**

An independent **agent** or middleman who acts as an intermediary between the **franchisor** and a prospective **franchisee**. **Franchise consultants** are commonly paid on a success basis by the **franchisor**. As **agents** of the **franchisor**, **franchise consultants** are required to act in accordance with all laws and regulations governing the sale of **franchises**.

### **Franchise Disclosure Document**

The **Franchise Disclosure Document** (FDD) is the form for providing disclosure in the U.S. under the **FTC Franchise Rule**. Before the 2007 amendments to the **FTC Franchise Rule**, the principal format

for providing disclosure in the U.S. was a document prepared under the “**Uniform Franchise Offering Circular**” (**UFOC**) format. The **FDD** provides extensive information about the **franchisor** and the **franchise** organization in a uniform format, which a prospective **franchisee** can use to compare different **franchise** offerings. The **FDD** is meant to give a potential **franchisee** certain specified information to help make educated decisions about their potential **investments**. Also see “**Disclosure Document**” and “**FTC Franchise Rule**.”

#### **Franchise Disclosure Laws**

Federal and State laws that require a **franchisor** to deliver a **franchise disclosure document** (“**FDD**”) to a prospective **franchisee** prior to selling a **franchise** to the prospect. See “**FTC Franchise Rule**” and “**State Franchise Disclosure Laws**.”

#### **Franchise Fee**

A sum of money the **franchisee** pays to the **franchisor** when the **franchise agreement** is signed. The fee may cover a variety of expenses, including but not limited to training costs, on-site startup costs, and promotional charges. Also called a “**License Fee**” or “**Initial Fee**.”

#### **Franchise Owner**

Please see “**Franchisee**.”

#### **Franchise Relationship Laws**

State laws regulating certain aspects of the **franchise** relationship, such as how and when a **franchisor** can terminate the **franchise agreement**, where lawsuits concerning the **franchise** relationship must be brought, and the circumstances under which a **franchisor** can refuse to permit the **franchisee** to renew the **franchise agreement**.

#### **Franchise Representative**

An employee of the **franchisor** whose responsibility it is to regularly visit with and assist **franchisees** within an assigned geographic area. **Franchise representatives**, also called **field representatives**, may inspect locations for quality and cleanliness; help

**franchisees** solve management or technical problems; troubleshoot; give moral support; act as liaison between **franchise** owner and **franchise** company; and offer advertising and marketing advice.

#### **Franchise Rule**

Please see “**FTC Franchise Rule.**”

#### **Franchise Sales Material**

Promotional and/or instructional materials made available to individuals who inquire about purchasing a **franchise**. Such “kits” commonly contain **disclosure documents**, a description of the business and history of the company, financial information, testimonials from current **franchise owners**, preliminary information about fees and costs, etc.

#### **Franchise Salesperson**

An **agent** of the **franchisor** whose business it is to market and sell **franchises**. The franchise salesperson’s role is to meet with prospective **franchisees**, present disclosure materials, gather the prospect’s financial information, answer questions, assist with obtaining financing, and facilitate the signing of a **franchise agreement**.

#### **Franchise Term**

The length of time for which a **franchisee** is granted licensing and other rights under the **franchise agreement**.

#### **Franchised Outlet/Unit**

Within a **franchise** system, a business location or **site** that is independently owned by an individual(s) to whom the **franchisor** has granted certain rights. For comparison see “**company-owned outlet.**”

#### **Franchisee**

The individual or individuals who own and operate a business under a licensing agreement granted by a parent company known as the **franchisor**. **Franchisees** are commonly are entitled to: use the **franchisor's trademark** and/or **trade name**; sell and/or market the **franchisor's** products and/or services; have access to the **franchi-**

sor's pertinent **trade secrets**; receive management and other training; enjoy marketing and advertising support; build **equity interest** in the business; and benefit from the **goodwill** of the **franchisor**. **Franchisees** can also be called "**Franchise Owners**."

#### **Franchisee Advisory Board**

A **franchisor**-sponsored organization of **franchisees**, either appointed by the **franchisor** and/or elected from among the **franchisees** at large, who represent or speak for the **franchisees** in discussions with the **franchisor**. Practices vary but **franchise advisory boards** may, with the approval of all **franchisees**, levy assessments; run marketing, advertising, and training programs; and represent grievances to the **franchisor**. Also called "Franchisee Advisory Council."

#### **Franchisee Association**

An independent association of **franchisees** who work together to address the issues that affect all **franchisees** within a given **franchise** system. **Franchisee Associations** generally speak for all **franchisees** who have chosen to join the association and are independent of, and not directed by, the **franchisor**. Also see "**Franchisee Advisory Board**."

#### **Franchisee/Franchisor Relations**

Refers to the manner in which **franchisee** and **franchisor** representatives interact. Such relations may be generally positive and cooperative or they may encounter periods of stress and distrust. To ensure smooth **franchisee/franchisor relations**, many **franchisors** have established **franchise advisory boards** comprised of **franchisees** who meet regularly with company representatives. Also see "**Franchisee Advisory Board**."

#### **Franchisee Training**

Education and instruction on how to properly run the business, which the **franchisor** provides to the **franchisee** after the **franchise agreement** is signed. The training may be provided as part of the **initial fee** or may be an added expense for the **franchisee**. The training may take place at the **franchisor's** training facility, at the **franchisee's** actual business location, or both.

### **Franchisee Validation**

During the process of investigating a **franchise** opportunity a prospective **franchisee** will interview current and past **franchisees**, obtaining unfiltered opinions about the quality of the **franchise** system.

### **Franchising**

A method of marketing products and/or services under which a **franchisor** licenses its **trademark** and operating system and/or know-how to a **franchisee** in exchange for both on-going fees paid by the **franchisee** to the **franchisor** during the term of the **franchise** and the **franchisee's** agreement to follow the **franchisor's** standards and specifications for the **franchise** system. **Franchise** arrangements have been subdivided into two broad classes: 1) Product distribution arrangements in which the dealer is to some degree, but not entirely, identified with the manufacturer/ supplier; and 2) entire **business format franchising**, in which there is complete identification of the dealer with the buyer.

### **Franchisor**

The **franchisor** owns the business system and associated **trademarks** or **trade names**. **Franchisors** allow **franchisees** to use these under license in a designated area and for a fee. They then support their **franchisees** both in starting their business and in continued support. Also called "**Franchise Company**."

### **FTC Advisory Opinion**

A finding of the **Federal Trade Commission** that addresses the propriety of certain **franchise** business practices and delivers an opinion on whether or not the practices conform with the **FTC's "Franchise Trade Rule."** The **FTC's** staff also issues informal staff advisory opinions that are not binding, but that give guidance about how the **FTC's** enforcement staff thinks about a particular fact pattern.

### **FTC Disclosure Document**

Please see "**Franchise Disclosure Document**."

### **FTC Franchise Rule**

A nationwide regulation issued by the **Federal Trade Commission** that principally requires **franchisors** to provide disclosure to prospective **franchisees**. The **FTC Franchise Rule** requires disclosure in the form of a “**Franchise Disclosure Document**” (or “**FDD**”). The **FTC Franchise Rule** was issued in 1978 and took effect in 1979; the regulation was extensively amended in 2007. There is no requirement to file the **FDD** with the **FTC**.

### **Full-Time Work Requirement**

This is a **franchise** system with a **franchise agreement** that requires the **franchisee** to be involved in the daily operations of the business on a full-time basis.

## **G**

### **Good Cause**

In **franchising**, “**good cause**” is commonly invoked as legally sufficient grounds or reason to support the actions of one or the other party, particularly in the case of nonrenewal or **termination** of the **franchise agreement**.

### **Goodwill**

The positive reputation or image that a **franchisor** has earned from the public. Although **goodwill** cannot be measured in precise monetary terms, image, reputation, public awareness, and acceptance all contribute to a company’s value or worth. Typically, the **goodwill** associated with a **trademark** does not legally transfer to the **franchisee**.

### **Gross Sales**

Total value of all sales prior to adjusting for costs or discounting.

### **Group Purchasing Power**

In **franchising**, the ability of a group of store operators, including **franchisees** and company-owned units, to obtain a lower price for

goods and materials when such goods and materials are purchased in large quantity. Also implied is the groups' greater influence with the supplier in terms of timely delivery, service, and so on.

**Guarantee**

A promise or assurance, especially one in writing, that something is of specified quality, content, or benefit; or that it will perform satisfactorily for a given length of time.

## H

**Household Cash Flow**

Total household income minus total household expenses over a predetermined period of time.

## I

**Independent Contractor**

For tax and legal purposes, an individual who is not classified as an employee but who is deemed to be in business for him- or herself.

**Infringement**

A trespass or **encroachment** upon one's rights; used especially in relation to invasions of the rights secured by patents, **copyrights**, and **trademarks**.

**Initial Fee**

Please see "**Franchise Fee**."

**Initial Investment**

The required amount of money required for a new **franchisee** to open and operate a location for at least three months. This must include all "start-up" expenses, but may not be reflective of total investment. Information about a prospective **franchisee's initial**



**Investment** can be found in Item 7 of the **Franchise Disclosure Document**.

**Injunction**

A judicial process or order requiring the person(s) to whom it is directed to do a particular act or to refrain from doing a particular act.

**International Franchise Association (IFA)**

The **International Franchise Association** is the world's oldest and largest organization representing **franchising** worldwide. In 2010, the **IFA** celebrated 50 years of excellence, education, and advocacy. The **IFA** protects, enhances, and promotes **franchising** through government relations, public relations, and educational programs. Through its awareness campaign highlighting the theme—Franchising: Building Local Businesses, One Opportunity at a Time—**IFA** promotes the 21 million jobs and \$2.3 trillion of economic activity generated by **franchising**. **IFA** members include **franchise** companies in over 90 different business format categories, individual **franchisees**, and companies that support the industry in marketing, law, and business development.

**International Franchising**

Refers to the expansion of **franchising** beyond national borders. A growing number of **franchisors** are currently operating **franchised** and/or **company-owned outlets** outside their home country.

**Investment/Equity Investment**

Please see "**Cash/Initial Cash Required.**"

# J

**Joint and Several Liability**

Where multiple parties, such as shareholders or parties owning a **franchised** unit, share equal financial and legal responsibilities and

therefore are together subject to any and all lawsuits or legal actions filed by creditors or other plaintiffs.

## L

### **Lanham Act**

A shortened name for the United States Trademark Act of 1946.

### **Lease Security Payment**

A payment made to the individual(s) who grants a lease on the property where a **franchise** is located. The **lease security payment** is most often paid by the **franchisee** to protect the leaseholder against losses in case of business failure or **default**.

### **Letter of Intent**

A written statement of intention to perform an act. In **franchising**, the **franchisor** sometimes provides to the prospective **franchisee** a **letter of intent** stating the company's intention to offer a **franchise agreement**. In commercial banking practices, a **letter of intent**, or **commitment agreement**, may state the bank's intention to make a loan to the prospective **franchisee**. **Letters of intent** are usually not binding legal commitments.

### **License Fee**

Please see "**Franchise Fee**."

### **Licensee**

Please see "**Licensor**."

### **Licensor**

In **franchising**, another term for "**franchisor**." The term is also used to describe the party who grants another the right to use its **trademark** in connection with the sale of the **licensor's** products without the use of the **licensor's** operating system.

### **Liquid Assets**

Please see "**Liquid Capital**."

**Liquid Capital**

Assets held in cash or in something that can be readily turned into cash. Also known as “**Liquid Assets.**”

**Location**

Please see “**Site.**”

**Logotype**

A **franchisor’s trademark** or name, as it is distinctively designed or written.

# M

**Management Fee**

A sum of money the **franchisee** pays for continuing management aid and assistance. Such fees may be included in the royalty or service fee or may be an additional charge.

**Manager Operated/Run**

A **franchise** system that does not require the **franchisee** to be personally involved in the daily operations of the **franchised unit** on a full-time basis. An operation that is well suited for investors and part-time involvement.

**Marketing Plan**

Generally, a **marketing plan** is a written document that details the necessary actions to achieve one or more marketing objectives. In regard to franchising, the marketing plan is a term that is often used as a short-hand way of describing the second element of the term “**franchise**” under the **FTC’s Franchise Rule**. Please also see “**Franchise.**”

**Master Franchisee**

A system whereby a **franchisor** grants to a party (usually referred to as the **Master Franchisee**) the right to operate **franchised** businesses and to grant **sub-franchises** to third parties, within an agreed-upon geographic area. The **Master Franchisee** serves as if it were the “**franchisor**” within the **sub-franchise** territory, provid-

ing localized support services within the territory. The **Master Franchisee** typically retains a portion of the royalty as compensation for its services.

**Maximum Investment Level**

Maximum dollar amount an investor is both comfortable and qualified investing (cash and borrowed) into a business. This amount generally includes both cash and debt.

**Minority Business Enterprise (MBE)**

An **MBE** is a business that is typically majority-owned and controlled by U.S. citizens who are members of certain defined minority groups. Some **MBEs** may be granted preferences in terms of obtaining **contracts**, for example, when municipalities control a venue, such as an airport concession authority on toll roads, etc.

**Multiunit Franchisee**

A **franchisee** that owns and operates more than one **franchised** location.

**Mutual Evaluation Process**

The understanding that both the **franchisor** and the prospective **franchisee** are evaluating each other during the due-diligence process to determine if it would be mutually beneficial to move forward into a **franchise** relationship.

# N

**Net Worth**

An individual's total assets minus their total liabilities.

**Non-compete Clause**

The provision in a **franchise agreement** which prohibits a **franchisee** from owning, operating, or having an interest in any competing business offering the same or similar products or services as those provided by the **franchise**. A **non-competition clause** may also prohibit the **franchisee** from involvement in any such competing business for a specified length of time following nonre-

newal or **termination** of the **franchise agreement**. Also called “**Non-Competition Clause**”.

## O

### **Offering Circular**

Please see “**Franchise Disclosure Document**.”

### **Offering Prospectus**

Please see “**Franchise Disclosure Document**.”

### **Opening Costs**

Total **franchisee** cost to start the business and remain operating for a reasonable period (typically defined as three months). **Opening costs** may include **franchise fees**, costs of real estate and or rent, zoning and business licenses, financing expenses, inventory expense, equipment, training fees, **working capital**, payroll, insurance, and salaries for employees. Please see “**Cash/Initial Cash Required**.”

### **Operating Controls**

Please see “**Quality Control**.”

### **Operations Manual**

The document detailing the operation of a particular **franchised** business. **Operations manuals**—also called **franchise** manuals—describe such items as: **quality control** requirements; recommended hours of operation and financial and management practices; the correct use of any **trademarks** or **trade names**; forms and written materials for use in business operations; payment of fees and **royalties**; approved suppliers; and so on. Increasingly, **operations manuals** also address other matters, such as system-wide policies concerning data, environmental and energy standards, health and safety matters, etc.

### **Owner Benefit**

This is a descriptive term that describes business income minus all “true” business expenses. Any benefit a **franchisee** receives from

the business—either through pass-through expenses, retirement contributions, dividends, distributions, or salary—is considered part of **Owner Benefit**. Other terms include “Owners Discretionary Profit” or “Earnings Before Interest Taxes Depreciation and Amortization (EBITDA) Plus Add-Backs.”

## P

### **Per Se**

When used in **antitrust law**, a “**per se**” violation is one that is inherently illegal once proven.

### **Personal Living Expenses**

The amount of money required for you and your family to live. Also called “Family Expenses.”

### **Pre-opening Promotion**

Special marketing, promotion, or advertising that precedes by some length of time the opening of a new **franchised** or **company-owned outlet**. **Pre-opening promotion** heightens consumer awareness and puts the new business on sound footing.

### **Preferred lender**

A lender that specializes in franchise financing and has a pre-existing relationship with a target **franchisor**.

### **Price Fixing**

A criminal violation of federal antitrust statutes in which several competing businesses reach a secret agreement (conspiracy) to set prices for their products or prevent real competition and keep the public from benefiting from the competition. “Horizontal **price fixing**” among competitors at the same level of commerce (for example, two or more **franchisees**) is typically “**per se**” illegal. Under a series of decisions reached by the U.S. Supreme Court, parties such as **franchisors** are permitted to specify a maximum and a minimum resale price, which may still be reviewed under federal **antitrust law** under the “**rule of reason**” standard.

**Principal Register**

The U.S. Patent and Trademark Office (USPTO) maintains a list of all **registered trademarks**. The USPTO list includes the “Principal Register.” When a **trademark** is listed on the **Principal Register**, it puts all parties in the country on constructive notice of the **registration** as well as the registrant’s use of the mark. When a mark has been included on the **Principal Register**, the owner of that mark is entitled to exercise all of the rights provided by the U.S. Trademark Act.

**Product Liability**

In **franchising**, the term implies the risk assumed by **franchisor** and **franchisee** in providing the **franchised** goods and/or services to the consuming public.

**Product Specifications**

Commonly spelled out in the **operations manual**, **product specifications** are precise and detailed descriptions and/or designations of ingredients, materials, goods, and other items used in the operation of the business.

**Product Standardization**

Related to **quality control**, **product standardization** is the **franchisor’s** effort to provide in every **franchised** and **company-owned outlet**, goods and/or services which are uniform in quality, appearance, and character.

**Profit Projections**

Please see “**Financial Performance Representation.**”

**Prospectus**

Please see “**Franchise Disclosure Document.**”

**Protected Area**

Please see “**Exclusive Territory.**”

**Protected Territory**

Please see “**Exclusive Territory.**”

**Public Offering Prospectus**

Please see “**Franchise Disclosure Document.**”

**Purchasing Power**

Please see “**Group Purchasing Power.**”

**Pure Franchising**

Please see “**Business Format Franchising.**”

## Q

**Quality Control**

The practices of a **franchisor** in supervising, regulating, and directing how business will be conducted in a **franchised** or **company-owned outlet**. Strict **quality control** is the **franchisor’s** most important method of insuring a uniform high-quality of product and services in all outlets. **Trademark** owners are required, under the U.S. Trademark Act, to police their marks and the products and services sold under those marks.

## R

**Reasonable Request**

Under the **Federal Trade Commission Rule**, **franchisors** and their sales representatives are required to provide the **Franchise Disclosure Document** to a prospective **franchisee** upon **reasonable request**. When the **FTC** issued the amended **FTC Rule** in 2007, the agency declined to provide a specific definition for the term “**reasonable request**,” noting instead that “determinations about ‘reasonableness’ can be made only on a case-by-case basis.”

**Registration**

In those states that have a state **franchise law**, **franchisors** must file an application to register before offering and selling **franchises** in that state. In some of these states, the application consists of filing a copy of the **franchisor’s FDD** as well as certain additional



forms. State **registration** applications typically are part of the public record.

#### **Registration State**

A state where there is a “**state franchise law**.” Currently CA, HA, IL, IN, MD, MI, MN, NY, ND, OR, RI, SD, VA, WA, WI. See “**State Franchise Laws**.”

#### **Relevant Market**

A way of identifying a market area according to its geography. In **franchising**, the term usually identifies the area in which a particular business entity has control.

#### **Renewable Option**

Please see “**Renewal**.”

#### **Renewal**

Most **franchise agreements** are for a specified period of time; at the end of that period the **franchisee** generally has the option to **renew** at a specified fee and upon signing the then current **franchise agreement**. The **franchise agreement** presented at **renewal** time may be substantially different from the one originally signed; for example, the **royalties** and **advertising fees** may be higher.

#### **Right of First Refusal**

A **franchisee’s** contractual right to purchase—if he so decides and if he can meet all conditions of sale established by the **franchisor**—any additional **franchised outlets** that may be for sale in the future within a pre-defined territory. This can also apply to a **franchisor’s** right to repurchase a **franchised unit** at the same price as offered by a third party.

#### **Royalty Fee**

A regular and continuing payment made by the **franchisee** to the **franchisor**, often paid on a weekly or monthly basis. The **royalty** may be a percentage of sales, a fixed recurring fee, or a combination. **Royalties** commonly cover use of a **trademark** and **trade name** and also constitute a fee for services performed by the **franchisor** such as training and assistance, marketing, advertising, accounting, and so on. Also called “**service fees**” and/or “**license fees**.”

### **Rule of Reason**

Under federal **antitrust law**, a method for judging illegality. Under the laws, certain practices are presumed to be illegal “**per se**” without regard to the precise harm they have caused or the business justification for their use. Other practices are judged under the “**Rule of Reason**,” under which the practices are generally deemed illegal only if, on balance, they harm competition. Also see “**Antitrust Law**.”

## **S**

### **SBA Certified Bank**

Commercial banks which have applied for and been accepted to participate in the U.S. Small Business Administration's loan **guarantee** program. (Also see **SBA guaranteed loan**). While any commercial lending institution may utilize the **SBA guaranteed loan** program, such Certified Banks are more likely to be familiar with the program, thus facilitating approval of the application.

### **SBA Guaranteed Loan**

A program of financial assistance available to small business owners from the U.S. Small Business Administration (SBA). While the SBA seldom loans money directly to **franchisees**, an **SBA guaranteed loan** makes it easier for a qualified individual to borrow money from a commercial lending institution, such as a bank. Under the program, the loan is made directly by the bank to the **franchisee**. The SBA protects the bank against financial loss in the event of business failure.

### **Service Fees**

Please see “**Royalty Fee**.”

### **Service Franchising**

A type of **franchising** which primarily provides a service, assistance or advice to the consumer. Service **franchises** are typically **business format franchises** and include, but are not limited to, the following: tax preparation, accounting, haircutting, staffing, window-washing, business coaching, real estate, maid services, dry cleaning, painting, etc.

**Service Mark**

Marks used to identify services, rather than goods, and used in the same fashion as **trademarks**. Also see “**Trademarks.**”

**Site**

The specific premises from which the **franchisee** is to conduct business. Also called “location” and “facility.”

**Site Selection**

The process of choosing the location for a **franchised** business. Professional **site selection** involves knowledge of such considerations as **demographics**, traffic patterns, buying habits, market characteristics, wage and employment patterns, zoning and other land use regulations, building and health code ordinances, and real estate patterns.

**Standardized Operating Procedures**

Please see “**Operating Controls.**”

**Start-up Costs**

Please see “**Initial Investment.**”

**State Addendum**

Refers to an additional document that contains additional disclosures required by a **registration state**. State addenda are added into the **FDD** as exhibits.

**State Franchise Laws**

In some states, a law requires **franchisors** to comply with certain requirements in addition to the **FTC Franchise Rule**. Typically, **state franchise laws** require a **franchisor** to do two things: 1) register with the state each year before starting to offer **franchises**; and 2) give disclosure. While most of these states have agreed to allow **franchisors** to use the **FDD** for providing disclosure, some states require slight changes or modifications to the **FDD**, which are accomplished through the use of state addenda and state amendments.

**Sub Franchisor**

Please see “**Master Franchisee.**”

### **Supplemental Register**

This is the secondary **trademark** register for the United States Patent and Trademark Office (USPTO). It allows for **registration** of certain marks that are not eligible for **registration** on the **Principal Register**, but are capable of distinguishing an applicant's goods or services. Marks registered on the **Supplemental Register** receive protection from conflicting marks and other protections, but are excluded from receiving the advantages of certain sections of the Trademark Act of 1946.

## **T**

### **Termination**

A declaration by the **franchisor** that part or all of the rights and obligations—of both parties—under the **franchise contract** cease or have ceased as of a certain date. Certain responsibilities and/or claims and damages may survive this **termination**, however. The conditions under which a **franchise** may be terminated by the **franchisor** are commonly addressed to in the **franchise agreement**.

### **Termination Legislation**

A number of states have passed **franchise** relationship laws which govern the reasons for and manner by which a **franchisor** may terminate or fail to renew a **franchise agreement**. Such so-called "**termination/non-renewal legislation**" also has been proposed in Congress from time-to time but has never been passed into law. Regulations regarding **termination** and nonrenewal therefore differ from state-to-state.

### **Territorial Restrictions**

Please see "**Exclusive Territory**."

### **Total Investment**

Please see "**Initial Investment**."

### **Trade Dress**

A term that refers to the visual appearance of an item, such as the interior or exterior of a building or a product's packaging. Typi-

cally, **trade dress** denotes some distinctive quality or look that is not functional, and that signals to consumers that the products, services, or the establishment is associated with a particular brand. The overall visual manner in which a **franchise** business presents itself to the public, including the interior and exterior design of buildings, its choice of color, use of dress of its employees, and so on.

#### **Trademark**

Any word, name, symbol, or device or any combination thereof adopted and used by a **franchisor** to identify its goods and/or services and distinguish them from those manufactured or sold by others. A careful **franchisor** grants only clearly defined or restricted use of its **trademark**. Such restrictions are spelled out in the **franchise agreement** and are therefore commonly referred to as “contractually limited use” of the **trademark**.

#### **Trade name**

Individual names and surnames, firm names, and **trade names** used by **franchise** companies to identify their business.

#### **Trade Secret**

A process, method, plan, formula, or other information unique to a **franchisor** that gives it an advantage over competitors. Appropriate legal provisions written into the **franchise agreement**, such as a **covenant not to compete**, are important in protecting **trade secrets**.

#### **Training Cost/Expense**

The money a **franchisee** pays for education and instruction. Training expenses may or may not include such items as: travel to and from the training location; room and board during training; the cost of tuition, books and supplies; and on-site startup aid. Practices vary, but training costs may be covered by the **franchise fee**.

#### **Transfer Rights**

Please see “**Assignment**.”

#### **Turn-key Operation**

A term used to describe a **franchise** that is so thoroughly organized, fully equipped, and professionally set up that the new **franchisee** need only “turn the key” in order to commence business.

### **Tying**

Under **antitrust law**, **tying** is a requirement imposed upon a buyer to purchase one product on the condition that the buyer also buy another product from the same seller. Whether alleged “**tying**” is illegal under **antitrust law** is often based on the facts of a particular case, and claims of **tying** are typically judged under the “**rule of reason**” standard.

## U

### **Uniform Franchise Offering Circular (UFOC)**

This term is no longer used. Please see “**Franchise Disclosure Document**”

### **Unilateral Termination**

Wherein one of the parties to the **franchise agreement** decides, without the other’s agreement, to put an end to the business relationship. **Unilateral termination** may be allowable with “**good cause**” and/or for pre-agreed reasons spelled out in the **franchise agreement**. Either the **franchisor** or the **franchisee** may seek to unilaterally terminate a **contract**; whether or not it is legal to do so will depend on circumstances and on the terms of the **contract**.

## V

### **Variable Cost**

Any costs that change significantly with the level of output, such as material costs.

### **Venture Capital**

A person or group of individuals who invest in a business venture, providing capital for start-up or expansion. **Venture capitalists** are looking for a higher rate of return than would be given by more traditional **investments**.

### **Vertical Restraints**

Restrictions imposed by a **franchisor** on its “downstream” customer or **franchisee**. An example of such restraint may be a limitation on where a **franchisee** may offer and sell products or services. Also see “**Price Fixing.**”

### **Vicarious Liability**

In **franchising**, “**vicarious liability**” typically refers to claims brought against a **franchisor** alleging that it is responsible for the action (or inaction) of a **franchisee** or one of its **franchisee’s** employees or **agents**.

### **Vision Statement**

A well-written **vision statement** will provide both direction and motivation to help you move toward a better future of your design. A well-developed **vision statement** includes measurement standards and target dates.

## **W**

### **Waiver**

In a typical **franchise agreement**, there is an “anti-waiver” clause, which states that one party’s acceptance of late performance or non-performance of an obligation by the other party does not waive the requirement that the same obligation be met in the future.

### **Working Capital**

A financial metric that represents liquidity available to a business or organization. A company can have both assets and profit but be short of liquidity if its assets cannot readily be converted into cash. Positive **working capital** is required to ensure that a firm is able to continue its operations and that it has sufficient funds to satisfy both maturing short-term debt and upcoming operational expenses.